

RAN-01-03
January 24, 2001

TO: All Members and Member Organizations

FROM: Department of Regulatory Policy

SUBJECT: Options Housekeeping Amendments
(File No. SR-PCX-99-44)

On December 28, 2000, the Securities and Exchange Commission approved a PCX proposal to make various housekeeping changes to the Options Trading Rules. The Exchange proposed to modify its rules pertaining to trading practices and procedures by clarifying existing provisions, eliminating superfluous provisions, incorporating current policies and procedures, and deleting certain Options Floor Procedure Advices (“OFPAs”) and incorporating relevant language from the OFPAs into the text of Rule 6.

Following is the text of the rule change that the SEC approved. Questions regarding this Bulletin may be directed to Peter Bloom at (415) 393-4166.

EXHIBIT A

Text of the Rule Change¹

RULE 6

OPTIONS TRADING

Rules Principally Applicable to Trading of Options Contracts

TRADING PRACTICES and PROCEDURES

* * *

¶5003 Order Book Official Defined

RULE 6.51(a). An Order Book Official (“OBO”) is an Exchange employee who is responsible for (i) maintaining the book with respect to the classes of options assigned to him; (ii) effecting proper executions of orders placed in the book; (iii) displaying bids and offers pursuant to Rule 6.55 and (iv) monitoring the market for the classes of options assigned to him.”

(b) - No change.

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¶5073 Trading Rotations

RULE 6.64(a). A “trading rotation” is a series of very brief time periods during [each of] which bids, offers, and transactions in only a single, specified option contract may [can] be made. Two Floor Officials [The Options Floor Trading Committee] may direct that one or more trading rotations be employed on any business day to aid in producing a fair and orderly market. For each rotation so employed, two Floor Officials [the Options Floor Trading Committee shall] must specify the particular option contracts to be included and the sequence of such option contracts in the rotation. Two or more trading rotations may be employed simultaneously, if two Floor Officials [the Options Floor Trading Committee] so prescribe[s]. Trading rotations may be employed at the opening and at the close of the Exchange each business day. Trading rotations, when held, will be conducted by the Order Book Official acting in such class of options. The rotations will be conducted in the following manner:

¹ New text is underscored and deleted text is in brackets.

[Moved from Rule 6.64, Commentary .01(a)] (b) Opening Rotations. The opening rotation, when used, will be held promptly following the opening of the underlying security on the principal market where it is traded. The Order Book Official will follow the following procedures when conducting an opening rotation:

[Moved from OFPA C-1] (1) As a rule, an Order Book Official acting in more than one class of options should open them in the same order in which opening transactions are reported in the underlying securities. In conducting each such opening rotation, the Order Book Official should first open the one or more series of options of a given class having the nearest expiration, and then proceed to series of options having the next distant expiration, and so forth, until all series have been opened.

(2) Prior to the opening of the underlying security on the primary market, the OBO will try to determine from the Floor Brokers the size and prices of those customer orders which are near the previous closing prices of those classes traded at the post.

(3) The OBO will then ask the Floor Brokers in the crowd what customer orders they are holding to be executed at the opening and, when possible, match all customer orders at the appropriate price.

(4) Except as other provided by two Floor Officials, if both puts and calls covering the same underlying security are traded, the Order Book Official will determine which type of options could open first, and may alternate the opening of put series and call series or may open all series of one type before opening any series of the other type, depending on current market conditions.

(5) After the underlying security has opened, the OBO will request markets in each of the series traded at the post from the primary Market Makers at the post.

(6) If the OBO believes that the response to a request for a markets is insufficient either as to price or size, the OBO may request markets from each Market Maker who did not respond and/or may call for supplemental Market Makers.

(7) If imbalances occur the OBO will allocate to the Market Maker or Market Makers who established that price.

[Moved from OFPA G-2] (8) Broker-dealer orders and/or Market Maker orders held by Floor Brokers with limit prices better than the opening price are not entitled to participate in the opening rotation unless the OBO has called for Market Maker and/or broker-dealer participation in response to an imbalance of customer orders.

(c) [(b)] - No change.

[Moved from Rule 6.64, Commentary .01(b)] (d) [(c)] Closing Rotations. Transactions may be effected in a class of options after 1:02 p.m. (Pacific Time) if they occur during a trading rotation. Such a trading rotation may be employed in connection with the opening or reopening of trading in the underlying security after 12:30 p.m. (Pacific Time) or due to the declaration of a “fast market” pursuant to Rule 6.28. The decision to employ a trading rotation after 12:30 p.m. will be publicly announced on the Trading Floor prior to the commencement of such rotation and Book Staff should notify Floor Brokers by 12:50 p.m., if possible, that a closing rotation may be necessary. The closing rotation should commence at least ten minutes after the Trading Floor has been notified. No more than one trading rotation may be commenced after 1:02 p.m. If a trading rotation is in progress and Floor Officials determine that a final trading rotation is needed to assure a fair and orderly close, the rotation in progress will be halted and a final rotation begun as promptly as possible after 1:02 p.m. Any trading rotation conducted after 1:02 p.m. may not begin until ten minutes after news of such rotation is disseminated. Only orders that have been entered before 1:02 p.m. are eligible for execution during the closing rotation.

(1) When a closing rotation is necessary, the Order Book Official shall use a single price closing procedure. In a closing rotation, customer orders will receive the same priority as they do during opening rotations.

(2) Except as otherwise provided by the Options Floor Trading Committee, if both puts and calls covering the same underlying security are traded, the Order Book Official shall determine the order of closing each series of such puts and calls in light of current market conditions, in the manner provided in paragraph (a) for opening rotations.

[Moved from Rule 6.64, Commentary .01(c)] (e) [(d)] A closing trading rotation shall be employed for each series of individual stock options on the last business day prior to its expiration. The closing rotation shall commence at 1:02 p.m. Pacific Time, or after a closing price of the stock in its primary market is established, whichever is later. Open trading on expiring series of index options shall be permitted on the last business day prior to expiration until 1:15 p.m. Pacific Time, but a closing rotation for such expiring series of index options shall not be employed.

[Moved from Rule 6.64, Commentary .02] (f) [(e)] For those option classes and within such time periods as the Options Floor Trading Committee may designate, members may, prior to opening rotation, enter option market quote indications based upon the anticipated opening price of the securities underlying such designated option class.

[Moved from OFPA A-1] (g) [(f)] Responsibility of Floor Brokers at the Opening.

(1) Rule 6.46(a) places a general responsibility upon Floor Brokers to use due diligence in executing orders entrusted to them. This will be interpreted to mean that Floor Brokers who do not fully cooperate with the OBO or other members in creating a single price orderly opening, or fail to notify the OBO of

the size and price of orders that they anticipate executing at the opening, or attempt to execute at the opening orders that are clearly too late to participate in the opening rotations, may be deemed in violation of this Rule.

(2) As an aid in facilitating an orderly opening, the Exchange will permit OBOs, as a convenience to Floor Brokers, to match market orders during the opening or any subsequent rotation. Orders so matched will be entered into Price Reporting by the OBO, and the Exchange will impose no charge for this service. However, a Floor Broker who elects to make use of this convenience must remain on the trading floor during the rotation. The Options Floor Trading Committee has determined that the OBO is under no obligation to accept CFOs and cancels of market orders placed with the OBO once the opening rotation for option contracts covering the same underlying security has begun.

(3) If a Floor Broker is unable to remain on the trading floor, he may notify the OBO that he has appointed another Floor Broker who will represent the order on his behalf in accordance with the provisions of Rule 6.66(d). If the Floor Broker fails to designate another Floor Broker to represent the order, the OBO shall select a Floor Broker in the crowd to receive the report copy and the provisions of Rule 6.66(d) will apply.

(4) Floor Brokers holding eligible market orders during a rotation who do not choose to avail themselves of the above procedures are cautioned that they may not disrupt an opening price once arrived at, nor may they presume automatic inclusion of their order in the opening.

Commentary:

[.01 Trading rotations may be employed at the opening and at the close of the Exchange each business day, as determined by the Options Floor Trading Committee. Trading rotations, when held, shall be conducted by the Order Book Official acting in such class of options. The rotations shall be conducted in the following manner:

(a) *Opening Rotations.* The opening rotation, when used, shall be held promptly following the opening of the underlying security on the principal market where it is traded. As a rule, an Order Book Official acting in more than one class of options should open them in the same order in which opening transactions are reported in the underlying securities. In conducting each such opening rotation, the Order Book Official should first open the one or more series of options of a given class having the nearest expiration, then proceed to series of options having the next most distant expiration, and so forth, until all series have been opened. Except as otherwise provided by the Options Floor Trading Committee, if both puts and calls covering the same underlying security are traded, the Order Book Official shall determine which type of option should open first, and may alternate the opening of put series and call series or may open all series of one type before opening any series of the other type, depending on current market conditions.

(b) *Closing Rotations.* Transactions may be effected in a class of options after 1:02 p.m. (Pacific Time) if they occur during a trading rotation. Such a trading rotation may be employed in connection with the opening or reopening of trading in the underlying security after 12:30 p.m. (Pacific Time) or due to the declaration of a “fast market” pursuant to Options Floor Procedure Advice G-9. The decision to employ a trading rotation after 12:30 p.m. shall be publicly announced on the trading floor prior to the commencement of such rotation. No more than one trading rotation may be commenced after 1:02 p.m. If a trading rotation is in progress and Floor Officials determine that a final trading rotation is needed to assure a fair and orderly close, the rotation in progress shall be halted and a final rotation begun as promptly as possible after 1:02 p.m. Any trading rotation conducted after 1:02 p.m. may not begin until ten minutes after news of such rotation is disseminated.

(1) When a closing rotation is necessary, the Order Book Official shall use a single price closing procedure. In a closing rotation, customer orders will receive the same priority as they do during opening rotations.

(2) Except as otherwise provided by the Options Floor Trading Committee, if both puts and calls covering the same underlying security are traded, the Order Book Official shall determine the order of closing each series of such puts and calls in light of current market conditions, in the manner provided in paragraph (a) for opening rotations.

(c) A closing trading rotation shall be employed for each series of individual stock options on the last business day prior to its expiration. The closing rotation shall commence at 1:02 p.m. Pacific Time, or after a closing price of the stock in its primary market is established, whichever is later. Open trading on expiring series of index options shall be permitted on the last business day prior to expiration until 1:15 p.m. Pacific Time, but a closing rotation for such expiring series of index options shall not be employed.

.02 For those option classes and within such time periods as the Options Floor Trading Committee may designate, members may, prior to opening rotation, enter option market quote indications based upon the anticipated opening price of the securities underlying such designated option class.]

.01 - .02 [.03 - .04] - No change.

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Trading Halts and Suspensions

Rule 6.65(a) - (c) - No Change.

Commentary:

.01 - No change.

.02 In the event that trading in any option is halted, it will [shall] be the responsibility of the Options Floor Official who authorized the trading halt and of the Order Book Official assigned to the option with respect to which trading was halted, to file a report with the Exchange Operations [Options Floor Trading Committee, with a copy to the Department of Member Firms,] setting forth the time and duration of such halt and the reasons therefor.

.03 - No change.

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Order Identification

Rule 6.66(a) - (c) - No change.

[Moved from OFPA A-7] (d) Floor Broker Identification. A Floor Broker acting as an agent for another Floor Broker in effecting a transaction must give up his own name as executing member. The practice of a Floor Broker acting as an agent for another Floor Broker and giving up the name of the latter as executing member, as though the latter were on the Floor and had actually made the trade, will not be permitted. This procedure shall apply in particular to situations arising from the matching of customer orders by the OBO during a rotation, as well as all other appropriate situations. The basis for this Rule lies in Rule 6.77, which states that all bids or offers made and accepted in accordance with the Rules shall constitute binding contracts. Since these contracts are binding upon the members who actually effected the transactions, their names must appear thereon.

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Orders Required to be in Written Form

Rule 6.67(a). *Transmitted to the Floor.* Each order transmitted to the Floor must be recorded legibly in a written form that has been approved by the Exchange, and the member receiving such order must record the time of its receipt on the Floor. Each such order must be in legible written form when taken to the post for attempted execution. **[Moved from Rule 6.67, Commentary .02]** Orders sent electronically through the Exchange's Member Firm Interface are deemed to be written orders for purposes of Rule 6.67.

(b) *Cancellations and changes.* Each cancellation of, or change to, an order that has been transmitted to the Floor must be recorded legibly in a written form that has been approved by the Exchange, and the member receiving such cancellation or change must record the time of its receipt on the Floor.

(c) *Executions.* A member transmitting from the Floor a report of the execution of an order must record the time at which a report of such execution is received by such member.

[Moved from OFPA F-5] (d) Hand Signals. The following regulations govern the proper use of hand signals on the Options Trading Floor:

(1) Hand signals may always be used to request and to relay information regarding current quotations and market size. Hand signals may also be used to increase or decrease the size of an order, to change the order's limit, to cancel an order or to activate a market order. Any cancellation of or change to an order relayed to a Floor Broker through the use of hand signals also must be relayed to the Floor Broker in a time stamped, written form immediately thereafter. All cancellations and changes of orders held by the Order Book Official must be in written form. Executing brokers who receive such communications must have a written order in their possession with all of the following information on the ticket:

- Underlying security ticker symbol
- Expiration month
- Striking price
- Volume
- Purchase or Sale Notation
- Whether Market or Limit Order

(2) Cancellation of orders held by the Floor Broker must be in written form in accordance with current practice. A Floor Broker may cancel an order through the use of hand signals if it is followed immediately by written cancellation.

(3) Any change to an order must be documented in writing outside of the crowd and the ticket time-stamped, before the revised order may be represented.

[Moved from Rule 6.67, Commentary .01] (e) Any member desiring to use an order form in a format other than that provided by the Exchange must submit such form to the Options Floor Trading Committee and obtain its approval prior to using such form on the Floor.

[*Commentary:*

.01 Any member desiring to use an order form in a format other than that provided by the Exchange must submit such form to the Options Floor Trading Committee and obtain its approval prior to using such form on the Floor.

.02 Orders sent electronically through the Exchange's Member Firm Interface are deemed to be written orders for purposes of Rule 6.67.]

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Record of Orders

Rule 6.68(a) - No change.

(1) - (7) - No change.

[Moved from OFPA D-11] (b) Record Retention. In addition to the white (control) copy, and/or hard copy, which must be kept for the entire amount of time specified in Securities Exchange Act Rule 17a-4, the green (commission) copy must also be retained for a minimum of 48 hours from the trade date. In the case of those orders executed by independent Floor Brokers, it is their responsibility to retain the green (commission) copy, and the executing member firm must retain the white or hard copy. Also, all such records must be readily available for use on the trading floor for the resolution of any problems relating to the execution of these orders.

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Reporting Duties

Rule 6.69(a) - (d) - No change.

Commentary:

.01 - No change.

[Moved from OFPA G-12] .02 Reporting of Trade Information. The responsibility for time-stamping and reporting of trades to the Order Book is as follows:

(a) one buyer, multiple sellers - responsibility is with the buyer

(b) one seller, multiple buyers - responsibility is with the seller

(c) one buyer, one seller - responsibility is with the seller

.03 For purposes of Rule 6.69(d), trade information includes the proper account origin codes, which are as follows: "C" for non-broker-dealer customer accounts; F for firm proprietary accounts; "M" for member Market Maker accounts; and "B/D" for firm orders of non-member broker-dealer accounts, stock specialist accounts, or customer account trades of the broker-dealer or non-member broker-dealer. In addition, Market Maker clearing firms are directed to instruct their respective trading desks to identify Market Maker orders that are entered from off the floor and not entitled to Market Maker margin treatment by placing a "C" after the Market Maker's number in the "firm" box on the ticket. Floor Brokers, when accepting an order by phone from a Market Maker, are similarly directed to identify that order in the same manner.

.04 Time stamping on the back of the hard card does not meet the Exchange's time stamp requirements because the hard card is not submitted to the Exchange.

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Price Binding Despite Erroneous Report

Rule 6.70 - No change.

Commentary:

[Moved from OFPA G-1] .01 Whenever the print of a transaction in an underlying security so differs from a previous print, or an opening sale differs from the previous close, or a bid or offer differs from a previous bid or offer, as to give rise to the probability that the print or market may have been erroneous, reasonable care should be exercised to verify the print or market prior to effecting transactions based thereon. Reference is made to Rule 6.65(a), which states that trading on the Exchange in any option contract shall be halted or suspended whenever the Exchange deems such action appropriate in the interests of a fair and orderly market and to protect investors.

In the event that transactions are made based on what is subsequently found to be an erroneous print or market, then all such transactions will be treated in accordance with Rule 6.46(b), which specifically refers to contingency orders and states that, unless mutually agreed to by the members involved, the results of such a trade shall not be altered by the fact that a print or market is subsequently found to be erroneous. The above notwithstanding, every effort must be made by all members involved to reach a mutual agreement in removing from the record any trades that are patently unfair in light of the actual price of the underlying security.

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Manner of Bidding and Offering

Rule 6.73 - No change.

Commentary:

[Moved from OFPA G-10] .01 Public Outcry/OBO Awareness. The “public outcry” requirement means that vocalization of market quotes (Rule 6.73) and transactions (Rule 6.69(.01)) at the post where the option is traded to be effective, must be in a tone loud enough to be heard by the members in the trading crowd. The OBO, under the provisions of Rule 6, has specific responsibilities and obligations for a fair, orderly and competitive marketplace. In addition, the OBO, with the concurrence of two Floor Officials and having solicited comments from the crowd, can require the revocalization of any transaction in dispute. Any transaction not meeting the “public outcry” definition will be deemed a “whisper trade” and in violation of the provisions of “just and equitable principles of trade.”

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Priority of Bids and Offers

Rule 6.75(a) - (b) - No change.

(c)(1) - (2) - No change.

[Moved from Rule 6.75, Commentary .03] (3) Broker/dealer orders and/or Market Maker orders held by Floor Brokers with limit prices better than the opening price are not entitled to participate in the opening rotation unless the OBO has called for Market Maker and/or broker-dealer participation in response to an imbalance of customer orders.

(d) - No change.

Commentary:

.01 - .02 - No change.

[.03 Pursuant to Rule 6.75(c), the Options Floor Trading Committee has determined that firm orders and Market Maker orders held by Floor Brokers with limit prices better than the opening price are not entitled to participate in the opening rotation unless the OBO has called for Market Maker and firm participation in response to an imbalance of customer orders.]

[Moved from OFPA A-3] .03 Procedure for Entering Orders in the Book Under Certain Circumstances. Rule 6.75 provides that priority as between two or more bids representing the highest price or two or more offers representing the lowest price shall be determined in accordance with the sequence in which the bids or offers are made, except that any such bids or offers displayed by the Order Book Official shall have priority. A condition may arise in which a Floor Broker holding a public order has been actively bidding or offering at a price better than that existing in the Book; and, subsequently, a new public order which would include a cancel/replace order (“CFO”) enters the crowd to be placed on the Book at a price equal to said bid or offer held by the Floor Broker. In the best interest of all public orders competing at the same price, under such circumstances, the earlier order should be afforded the opportunity to be entered on the Book prior to the new order provided, however, that a CFO that merely reduces the size of an existing order on the Book will not be considered to be a new order.

This procedure is applicable only to such an earlier order that has been actively represented in the crowd. This will be interpreted to mean that it has been bid or offered at a specific price by public outcry for a period of time, and will not apply to any orders represented in the crowd whose existence has not been clearly evident to other participants. Additionally, this procedure will apply only when a single Floor Broker is making the best bid or offer in the crowd. If two or more Floor Brokers are competing at the same price, and a new equal order is entered in the Book, neither of the original competing Brokers will be entitled to precede the new order since they had, in effect, waived their rights to priority by competing with each other.

[Moved from OFPA G-5] .04 *Combination, Spread and Straddle Orders.*

Following are the proper trading procedures[, under Rule 6.75(d),] for combination, spread and straddle orders:

(a) *Announcing the Order.* Any member holding a combination, spread, or straddle order must write it on one ticket and must bid or offer for each series in the order. The member may express the order as it applies to each separate series or may express the order at its total or net debit/credit alone, so long as it is clear that the member is attempting to execute both series as a combination, spread, or straddle. The executing member must ensure that the trading crowd is aware of the request for a market and has an opportunity to participate in the transaction.

(b) *If The Book's Market is on Both Sides of the Order.* First, a member entering a crowd must always check to see if the Book has the best market in either series and if the order can be executed against any bids and/or offers at the member's limit in both series in the Book. If the order may be executed by a combination of transactions with the Book in both series on a one-for-one basis, the member must trade the lesser number of contracts shown by the Book in both series.

(c) *If the Book's Market is on One Side of the Order.* If the Book is on just one side of the order, the executing member must determine who responds first to the request for a market and how that response is vocalized. If a bid or offer for one series in the order is vocalized first, the executing member must trade with the responding member, and the Book in the other series, for the same number of contracts as remain in the Book. If a response at the total or net debit/credit is vocalized first, then the responding member has priority over the Book and the existing markets on a one-for-one basis.

(d) *If the Book Has No Markets for the Order.* The following rule of priority applies when there are no markets in the Book against which the order can be executed. After the executing broker requests a market, the broker must trade with the first response vocalized at or within the broker's limits. If this response is in the form of a bid or offer for the net debit/credit, then that member has priority on a one-for-one basis. If the first response is for one series only, the executing broker must trade the other side of the order against the existing market in the crowd. If the executing broker cannot trade the other side of the order in the crowd, priority reverts to the member willing to trade both sides of the order on a one-for-one basis.

(e) *Partial Executions.* Partial execution of an order, with more than one member may occur so long as each member with whom that order is executed participates on a one-for-one basis with respect to each series involved in the order.

(f) If there is a Locked Book Market. The situation may occur when the only prices at which the order may be executed are equal to the Book's bids or offers for both series involved in the order. If those prices are the only prices at which the order may be executed, then the order will be given priority over the Book. For example, a Floor Broker enters the crowd with a spread order to sell the XYZ April 20/July 20 call spread for a credit of 1. The Book's bids and offers for these two series are:

XYZ April 20: 15/16 - 1 1/6

XYZ July 20: 2 - 2 1/6

Book's market for the April 20/July 20 spread is 15/16 - 1 1/16.

The spread cannot be executed by accepting the Book's bid of 2 for the XYZ July 20s and the Book's offer of the XYZ April 20s at 1 1/16. There are no other prices within the Book's bids and offers at which the spread may be done. The spread may be done, however, if the XYZ July 20s are sold at 2 1/16 and the XYZ April 20s are bought at 1 1/16 or the July 20s are sold at 2 and the April 20s are bought at 1. Although these prices are equal to both Book bids or both Book offers, this spread may be done in the crowd with one other member on a one-for-one basis at 1 and 2 or 1 1/16 and 2 1/16.

(g) Limits on Pre-emptive Right. This pre-emptive right pertains only to combinations, spreads, or straddles of equal quantities or to the lesser quantity when the quantities of contracts involved are unequal.

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Priority of Split Price Transactions

Rule 6.76(a). *Purchase priority.* If a member purchases one or more option contracts of a particular series at a particular price or prices, the member must [he shall], at the next lower price at which another member bids, have priority in purchasing up to the equivalent number of option contracts of the same series that the member [he] purchased at the higher price or prices, provided that the member's [his] bid is made promptly and continuously and that the purchases effected represents the opposite side of a transaction with the same order or offer as the earlier purchase or purchases.

(b) - (c) - No change.

Commentary:

.01 - No change.

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NOTE: Pursuant to the rule change, the following Options Floor Procedure Advices (“OFPAs”) are deleted:

- A-1 Responsibility of Floor Brokers at the Opening
- A-3 Procedure for Entering Orders in the Book Under Certain Circumstances
- A-7 Floor Broker Giving Up a Name Other Than His Own as Executing Member
- C-1 Procedures for Opening Rotations
- D-7 Expressing Fractions in Writing
- D-8b Priority on Split Price Transactions
- D-11 Record Retention Requirements
- F-1 Admission to the Trading Floor
- F-5 Means of Communication on the Options Floor
- G-1 Options Transactions Based on Erroneous Prints of Underlying Security
- G-2 Imbalance of Orders at Openings
- G-5 Trading Procedures for Combination, Spread, or Straddle Orders Under Priority Rules
- G-10 Public Outcry/OBO Awareness
- G-12 Reporting of Trade Information