

Regulatory Circular #RG98-96

Date: September 14, 1998

To: Designated Primary Market Makers (DPMs) and Order Book Officials

From: Regulatory Services Division

Re: Reporting Unusual Activity

The Regulatory Services Division would like to remind Designated Primary Market-Makers (DPMs), those approved to act on behalf of DPMs, and Order Book Officials (OBOs) that DPMs and OBOs are required to report any unusual activity to the Exchange.

Specifically, Exchange Rule 7.6 provides that when, in the opinion of an OBO, there is any unusual activity, transaction, or price change or there are other unusual market conditions or circumstances which are, with respect to the classes in which the OBO is acting as an OBO, detrimental to the maintenance of a fair and orderly market, the OBO shall promptly make a report of this activity to a Floor Official. Additionally, Exchange Rule 8.80(c)(8) requires DPMs to perform the functions of an OBO in their allocated classes. Accordingly, DPMs and those approved to act on behalf of DPMs are also required to report to a Floor Official any unusual activity in their allocated classes.

Unusual activity should be reported on the form labeled "OBO Unusual Activity Report" and the completed form should be delivered to the Trading Procedures Office on the fourth floor or directly to a Trading Floor Liaison (TFL) staff member to assure compliance with the above mentioned rules.

Examples of conduct which would warrant unusual activity reports include but are not limited to:

- one or more trades or quote changes at the end of the day for the apparent purpose of marking, *i.e.* trades or quotes which unduly or improperly influence the mark-to-market price or which do not reflect the true state of the market;
- trades or quotes which appear to create a false, misleading or artificial appearance of activity in an option, such as
 - multiple small volume trades effected by a market-maker in order to inflate his or her in-person percentages thereby meeting the 25% or 80% requirements specified in Rule 8.7.;
 - a pattern of quotes and trades in a new product which appear to be effected for the sole purpose of creating or inflating an appearance of public customer interest in that product or for the sole purpose of publishing or establishing a presence in industry news;
- conflicts between members at the trading station, including market-makers or floor brokers who are not regularly present at the station, which may constitute

harassment or are not otherwise reasonably calculated to contribute to the maintenance of a fair and orderly market;

- agreement of a member to accept for clearance any transaction in which he or she was not involved or, conversely, the failure of any member to accept for clearance any transaction in which he or she was actually involved.

OBOs and DPMs should note that reportable unusual activity does not necessarily need to directly involve the OBO, DPM or its staff.

OBO Unusual Activity Report forms and copies of Exchange Rules 7.6 and 8.80 are being distributed to all DPMs and OBOs along with this Regulatory Circular.

Questions regarding the obligations of DPMs should be directed to Daniel Hustad at (312) 786-7715 or to Margaret Williams at (312) 786-7834. Questions regarding OBO Unusual Activity Reports should be directed to Trading Floor Liaison staff members Greg Rich (page 9000) or Craig Johnson (page 9007).

(97-136 revised)

Rule 7.6. Duty to Report Unusual Activity

When, in the opinion of a Board Broker or Order Book Official, there is any unusual activity, transaction, or price change or there are other unusual market conditions or circumstances which are, with respect to any option contract in which he is acting as Board Broker or Order Book Official, detrimental to the maintenance of a fair and orderly market, he shall promptly make a report to a Floor Official.

⇒ Amended January 11, 1979.

...Interpretations and Policies:

.01 To the extent unusual activity is apparent only through the inspection of trade tickets, a Board Broker or Order Book Official is not responsible for reporting such activity unless the trade tickets are brought to his attention.

⇒ Issued March 30, 197+8; amended January 11, 1979.

Rule 8.80. Modified Trading System

(a) [Deleted April 16, 1998. (See Rule 8.95.)]

(b) The Modified Trading System ("MTS") Designated Primary Market-Makers ("DPM") shall be selected and removed as follows:

(1) The selection and removal of DPMs will be conducted by the MTS Appointments Committee ("MTS Committee" or "Committee"). The Committee will consist of the Vice-Chairman of the Exchange, the Chairman of the appropriate Market Performance Committee, and nine other members, to be nominated by the Nominating Committee and appointed by the Board, whose business functions are as follows: Six market-makers, one floor broker not associated with a member organization that conducts a public customer business, and two persons associated with member organizations that conduct a public customer business. The nine appointed committee members shall have two year terms four or five of which will expire each year.

(2) Any regular member or member organization is eligible for appointment as a DPM. The MTS Committee will select that candidate who appears best able to perform the functions of DPM in the designated options class or classes. Factors to be considered for selection include the following: adequacy of capital, experience with trading the option class or a similar option class, willingness to promote the Exchange as a marketplace, operational capacity, support personnel, history of adherence to Exchange rules and to all criteria specified in this Rule as DPM responsibilities, and trading crowd evaluations under Rule 8.60.

(3) Applications for DPM appointment by member organizations shall include the name of specified nominees. The MTS Committee shall specify whether a DPM appointment is as an individual, or as a member organization. The Committee may also specify any one or more conditions on the appointment, in respect of any representations made in the

application process, including but not limited to capital, operations, or personnel. The DPM is obligated promptly to inform the Committee of any material change in financial or operational condition, or in personnel. The appointment may not be transferred without approval of the MTS Committee. The DPM shall serve until he is relieved of his obligations by the Committee.

(4) The MTS Committee may, in its discretion, open an option class or classes to a new DPM selection process under any of the following circumstances:

(i) If upon review, the Committee determines that a DPM has not performed satisfactorily any condition of his appointment under Subpart (b)(3) or his functions as described in subpart (c) hereof. The Committee may conduct reviews of appointments at any time, and shall do so at least quarterly.

(ii) If a DPM incurs a material financial, operational, or personnel change. Provided, however, that the Committee shall open an option class or classes to a new DPM selection process upon request, if a DPM member organization changes its specified nominee and the former nominee so requests.

(iii) If for any reason the DPM should no longer be eligible for appointment, should resign appointment, or fail to perform his duties.

The incumbent DPM may apply for the appointment in the new selection process.

(5) The MTS Committee has discretion to relieve a DPM of his appointment due to a material financial, operational, or personnel change warranting immediate action.

(6) If a DPM has been relieved of his appointment or the appointment otherwise becomes vacant, the MTS Committee has discretion to appoint an interim DPM pending the conclusion of a new DPM selection process. The appointment as interim DPM is not a prejudgment of the new DPM selection process.

(7) [Deleted April 16, 1998. (See Rule 8.95.)]

(8) If the MTS Committee decides to terminate a DPM's appointment under subpart (b)(7) of this Rule, the terminated DPM will receive a proportionate share of the net book revenues, not to exceed one-half, for any period specified by the Committee up to a maximum of five years. This award will take into account the length of time of DPM service, capital commitment and efforts expended during the DPM appointment.

(9) The hearing process before the MTS Committee will be as follows:

(i) Appointment Decisions:

Each applicant for appointment as DPM will be given an opportunity to present any matter which he wishes the Committee to consider in conjunction with the appointment decision. The Committee may require that presentation to be solely or partially in writing, and may require the submission of additional information from an applicant,

member, or any person associated with a member. Formal rules of evidence do not apply to these proceedings.

(ii) Decisions to Terminate Appointments:

The DPM who is the subject of Committee review in conjunction with the termination of a DPM appointment will be so advised and given an opportunity to present any matter which he wishes the Committee to consider in conjunction with the termination decision. The procedure shall be as described in paragraph 9(i) above.

(iii) Review:

A DPM relieved of an appointment under subpart (b)(5), (6) or (7) of this Rule, and, in the case of a member organization DPM, the relieved nominee, may seek review of that decision under Chapter XIX of the Rules. A DPM relieved of an appointment under subpart (b)(4) of this Rule may also seek review of that decision under Chapter XIX of the Rules, but only if he applies for reappointment and is denied.

(10) The MTS Committee may perform all functions of a Market Performance Committee under the Rules in respect of review and evaluation of the conduct of DPMs in the classes of his DPM appointment, including but not limited to Rules 6.71, 8.1, 8.2, 8.3, 8.7, and 8.60. The process for review of any action taken by the MTS Committee under this subpart shall be the same as if the action had been taken by a Market Performance Committee.

(c) The DPM is a member who functions in approved classes as a market-maker, floor broker, and in the place of the Order Book Official ("OBO") exempt from Rule 8.8. In acting as a market-maker, the DPM shall fulfill all obligations of a market-maker in his appointed option class or classes. In acting as a floor broker, and in place of the OBO in appointed options classes, the DPM shall fulfill his obligation of due diligence (and all other obligations associated with these functions). In addition, the DPM shall:

- (1) assure that disseminated market quotations are accurate.
- (2) assure that each disseminated market quotation in appointed options classes shall be honored up to five contracts, or such other minimum number as set from time to time by the MTS Committee.
- (3) determine any formula for generating the automatically updated market quotations, disclosing the elements of the formula to the members of the trading crowd.
- (4) in addition to fulfilling general market-maker obligations under Rule 8.7, be present at the trading post throughout every business day, and, with respect to his trading as market-maker, effect trades which have a high degree of correlation with the overall pattern of trading for each series in the options classes involved.
- (5) participate at all times in any automated execution system which may be open in appointed option classes.
- (6) resolve trading disputes, subject to Floor Official review upon the request of any party to the dispute.

(7) In executing transactions for his own account as market-maker, the DPM shall

(i) accord priority to orders he represents as floor broker over his activity as market-maker;

(ii) have a right to participate pro rata with the trading crowd in trades that take place at the DPM's principal bid or offer; and

(iii) not initiate a transaction for his own account that would result in putting into effect any stop or stop limit order which may be in the book or which he represents as floor broker except with the approval of a Floor Official and when the DPM guarantees that the stop or stop limit order will be executed at the same price as the electing transaction.

(8) In appointed options classes and in other securities traded subject to the rules in Chapter XXX for which a DPM has been appointed, the DPM shall perform all functions of the Order Book Official, pursuant to Rules 7.3 through 7.10, and may, but is not obligated to, accept non-discretionary orders which are not eligible to be placed on the public order book, and to represent such orders as a Floor Broker. The DPM may not represent discretionary orders as a Floor Broker or otherwise. All orders in the DPM's possession which are eligible to be booked shall be booked.

(9) The DPM is designated to disclose book information under Rule 7.8.

(d) The Exchange shall continue to be responsible for the maintenance, handling, and billing of the book in option classes in which a DPM has been appointed, and shall retain and compensate the DPM for performing the OBO function. The Exchange will make personnel available to assist the DPM, as the DPM shall require in the DPM's OBO function, for which personnel the Exchange may charge the DPM a reasonable fee.

⇒ **Formerly Rule 8.13, renumbered, June 13, 1989 (89-04). Approved September 22, 1987 (87-18); amended August 22, 1989 (89-17); October 19, 1990 (90-08); September 13, 1991 (91-35); January 5, 1994 (93-51); amended November 22, 1994 (94-36); amended December 2, 1997 (97-61); amended 4/16/98 (98-06).**

...Interpretations and Policies:

.01 Willingness to promote the Exchange as a marketplace includes assisting in meeting and educating market participants (and taking the time for travel related thereto), maintaining communications with member firms in order to be responsive to suggestions and complaints, responding to suggestions and complaints, responding to competition in offering competitive markets and competitively priced services, and other like activities.

.02 Every registered DPM shall maintain a cash or liquid asset position in the amount of \$100,000 or in an amount sufficient to assume a position of twenty trading units of each security in which the DPM holds an appointment, whichever amount is greater. In the event that two or more DPMs are associated with each other and deal for the same DPM account, this requirement shall apply to such DPMs as one unit, rather than to each DPM individually.

⇒ **Adopted October 22, 1987.**

.03 In addition to his responsibilities as a Market-Maker, a person appointed to serve as DPM in one or more securities traded subject to the rules in Chapter XXX shall continuously maintain on the floor of the Exchange a two-sided market in the securities for which he has been appointed, consisting of a current bid and a current offer for his account, at prices reasonably calculated, under existing circumstances, to contribute to the maintenance of a supply of and demand for such securities sufficient to afford liquidity to other buyers and sellers of such securities whose orders are represented on the Exchange floor.

⇒ **Approved October 19, 1990 (90-08).**

.04 A DPM appointed to act as such in one or more securities traded subject to the rules in Chapter XXX is obligated to fill any odd lot portion combined with a round lot order for such a security at a price determined in accordance with Interpretation and Policy .05 under Rule 30.22.

⇒ **Adopted April 16, 1998 (operative May 17, 1998 (98-14)).**