REGULATORY CIRCULAR RG99-115

Date: April 28, 1999

To: Members and Member Firms

From: Division of Regulatory Services

Re: Guidelines Concerning Discretionary Accounts

Please Route To: **Compliance Department**
Senior Registered Options Principal
Compliance Registered Options Principal
Registered Options Principals / Branch Office Managers

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Discretionary Accounts

Exchange Rule 9.10 - Discretionary Accounts requires that no member organization may exercise discretionary power with respect to trading in options contracts in a customer's account without the customer's prior written authorization and written firm approval. This rule also applies to individuals who are associated with a member firm.

Key Issues

- Other than for time or price, a Registered Representative's use of discretion requires the customer's prior written authorization and the firm's approval.
- Other than for time or price, verbal authorization for the use of discretion is insufficient.
- Third-party discretion requires a signed trading authorization or power-of-attorney and the firm's approval.

Discussion

The Division believes that some clarification regarding the use of discretion in public customer accounts, including time and price discretion and third-party discretion, is warranted.

- To be considered a **non-discretionary**, or **authorized**, order, a customer needs to authorize, prior to entry and execution, the following terms of the transaction: size of trade (number of contracts or dollar amount); underlying security or index; expiration month; expiration year (if applicable); strike price; type of option (put or call).

- **Time and Price Discretion** is allowable under Exchange rules and does not require prior written customer authorization and firm approval. Time and price discretion is defined as when the aforementioned terms of the order are discussed with the customer prior to entry and execution and the only remaining elements not discussed are the time when or the price at which the order shall be executed. The allowance of time and price discretion must be granted by the customer, but may be done verbally. A member firm's written supervisory procedures may or may not allow the use of time and price discretion or may only permit the use of time and price discretion for a limited period of time.

- The placement of an order by a Registered Representative in which discretion, other than time and price, is used on any of the terms of such order without the customer's prior written authorization for the use of such discretion, would be considered a **discretionary trade without prior written customer authorization and firm approval**, a violation of Exchange Rule 9.10(a).

- The placement of an order by a Registered Representative without prior customer approval would constitute an **unauthorized trade** and would be considered a violation of Exchange Rule 9.10(a).

- The acceptance of an order from a party not named to a customer account, or from a party not authorized to place trades on behalf of a non-natural person account (such as a trust or corporation), is considered **third-party discretion**. This would include an order for an individual customer account of a spouse. Proper use of third-party discretion requires that a signed trading authorization or power-of-attorney be obtained in a form acceptable under a member firm's written supervisory procedures. The improper use of third-party discretion would be considered a violation of Exchange Rule 4.1 - Just and Equitable Principles of Trade.

Questions regarding this Regulatory Circular should be directed to David E. Carlson at (312) 786-7052 or Barry J. Szurgot at (312) 786-7756, in the Department of Financial and Sales Practice Compliance.