

**RAN-00-21**  
**August 8, 2000**

**TO: ALL PCX Members and Member Organizations**

**FROM: Department of Regulatory Policy**

**SUBJECT: Conversion to Decimals**  
**SR-PCX-00-23**

On August 7, 2000 the Pacific Exchange Inc. filed its rules pertaining to the industry wide conversion to decimalization. The rule proposal is effective upon filing and requires that beginning on August 28, 2000 13 designated equity securities be quoted in decimals with a minimum price variation (“MPV”) of .01. Also, on the same date, options overlying the 13 equity securities will begin to be quoted in decimals with an MPV of .05 for all options quoted under \$3.00 and an MPV of .10 for all options quoted at or greater than \$3.00.

Attached is the text of the rule change that the SEC has approved. Questions about this bulletin should be directed to Hassan Abedi, Staff Attorney, Regulatory Policy at (415) 393-5958.

**EXHIBIT A**

**PACIFIC EXCHANGE EQUITIES INC.  
CONVERSION TO DECIMALS**

**Text of the Proposed Rule Change:<sup>1</sup>  
DRAFT of 8/7/00**

**EQUITIES TRADING**

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**Trading Differentials**

Rule 7.10(a) The Corporation ~~shall~~ has determine determined the minimum price variation (“MPV”) ~~trading differentials~~ for equity securities traded on the Corporation. For those equity securities that are quoted in decimals the MPV will be .01. Those equity securities that are quoted in fractions will continue to be governed by the existing MPVs contained within the PCX Rules.

This rule will govern the activity of all ETP Holders, Equity ASAP Holders, and ETP Firms when their conduct relates to trading of issues quoted in decimals. However, this rule in no way diminishes the obligations of ETP Holders, Equity ASAP Holders, and ETP Firms to abide by the current rules of the Exchange when their business activity relates to trading of issues quoted in fractions.

*Commentary:*

.01 The Exchange may only change the trading differentials for equity securities traded on the Exchange by filing a rule change proposal with the SEC, pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 (effective upon filing).

.02-.03 – No change.

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<sup>1</sup> Underscoring indicates new text.

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Firm Quotations

Rule 7.12(b) – No change.

Commentary:

.01 - .04 – No change.

.05 No offer shall be executed in violation of applicable short sale rules:

Example:

PCX market in XYZ— 43.25 – 43.50 or 43 1/4 – 43 1/2 (short)

NYSE market in XYZ— 43.40 – 43.60 or 43 3/8 - 43 5/8

Consolidated tape last sale = 43.40 or 43 3/8

The Pacific Exchange offering at 43.50 or 43 1/2 may not be filled at its limit price subsequent to a Consolidated Tape sale at 43.60 or 43 5/8. However, any approved trader entering a short offering into the quote system is responsible for promptly adjusting the order into conformity with applicable short sale rules.

.06 - .08 – No change.

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Priority of Bids and Offers

Rule 7.19(c) – No change.

(1) Price Priority. A bid or offer will have price priority over another bid or offer only if its price exceeds the price of the other bid or offer by the MPV.

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Method of Crossing

Rule 7.41(b) – No change.

Commentary

.01-.05 – No Change

.06 For purposes of this Rule, the term “closest trading differential” means the MVP.

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**Short Sales**

Rule 7.40(a) – (c) – No change.

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**Exceptions**

Rule 7.40(d) – The provisions of subsection (a) hereof shall not apply to:

(1) – (11) – No change.

(12) Any sale of a security occurring when the last sale in that security is on a downtick of less than the MPV.

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**¶7914L**

**Intermarket Trading System**

Rule 7.66(a) – No change.

Rule 7.66(b) – No change.

(1) – (7) – No change.

(8) Openings on the Exchange

(i) Notification Requirements

(A) Applicable Price Change

(1) Initial Notification—Whenever a specialist, in arranging an opening transaction on the Corporation in any Eligible Listed Security, anticipates that the opening transaction through the facilities of the Corporation will be at a price that represents a change from the security's previous day's consolidated closing price of more than the “applicable price change” (as defined below), he shall notify the other Participant markets of the situation by sending a “pre-opening notification” through the

System. Thereafter, the specialist shall not open the security in his market until not less than three minutes after his transmission of the pre-opening notification. The “applicable price changes” are:

<u>Security</u>	<u>Consolidated Closing Price</u>	<u>Applicable Price Change (More Than)</u>
Network A	Under \$15	<u>.10</u> or 1/8 point
	\$15 or over	<u>.25</u> or 1/4 point
Network B	Under \$5	<u>.10</u> or 1/8 point
	\$5 or over	<u>.25</u> or 1/4 point

—A pre-opening notification shall:

- (A) be designated as a pre-opening notification (“IND”);
- (B) identify the participant market (“P”), the specialist and the security (“XYZ”); and
- (C) indicate the “applicable price range” by being formatted as a standardized pre-opening administrative message as follows:  
IND N/XYZ (RANGE)

The price range shall not exceed the “applicable price range” shown below:

<u>Security</u>	<u>Consolidated Closing Price</u>	<u>Applicable Price Change (More Than)</u>
Network A	Under \$50	<u>.50</u> or ½ point
	\$15 or over	1 point
Network B	Under \$10	<u>.50</u> or ½ point
	\$10 or over	1 point

The price range also shall not straddle the previous day's consolidated closing price, although it may include it as an endpoint (e.g., a .10 - .60 or 1/8 - 5/8 price range would be permissible if the previous day's consolidated closing price were .10 or .60 or 1/8 or 5/8, but not if the closing price were .25, or .40 or .50 or 1/4, or 3/8 or 1/2.

- (1) – No change.

*Commentary:*

01. – 03. – No change.

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**¶7914M** **ITS “Trade Throughs” and “Locked Markets”**

Rule 7.67(a) Definitions

(1) – No change.

A) A trade through is deemed to be *de minimus* when the amount of the trade through is less than the MPV.

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**¶7912D** **Evaluation of Specialist Performance**

Rule 7.29(a) – No change.

.01 For purposes of this rule, the term “price improvement” means an improvement in price by at least the MPV.

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**¶7914Z** **Information on Tape**

Rule 7.79(e). The terms of a Special Offering shall be printed on the tape before it is effective, with statement, if such be the fact, that stabilizing transactions have been effected or are contemplated and that it is intended to over allot shares as permitted by Rule 7.79(c)(1). Transactions effected pursuant to a Special Offering shall when feasible be printed currently on the tape, and the tape shall show the gross price and the special commission in a legend such as “SP OFF 100 XYZ 40 COM .50 or 1/2,” as well as the number of orders involved in such transaction where more than one order is involved; and after the close of the market, any unprinted remainder of such transactions executed during the day shall be so printed. When the offering is terminated, an announcement to that effect shall be printed on the tape; and when the intention to stabilize is terminated, such fact shall be announced on the tape together with a statement that stabilizing transactions have been effected, if such be the fact.

**EXHIBIT B**

**PACIFIC EXCHANGE INC.  
CONVERSION TO DECIMALS**

**Text of the Proposed Rule Change:<sup>2</sup>  
DRAFT of 8/7/00  
OPTIONS TRADING**

**¶4935 Obligations of Market Makers**

Rule 6.37 (a) – (b) – No change.

(1) Bidding and/or offering so as to create differences of no more than

(A) .25 or 1/4 of \$1 between the bid and the offer for each option contract for which the bid is less than \$2,

(B) no more than .40 or 3/8 of \$1 where the bid is \$2 or more but does not exceed \$5,

(C) no more than .50 or 1/2 of \$1 where the bid is more than \$5 but does not exceed \$10,

(D) no more than .75 or 3/4 of \$1 where the bid is more than \$10 but does not exceed \$20, and

(E) no more than \$1 when the last bid is \$20 1/8 or more, provided that the Options Floor Trading Committee may establish differences other than the above for one or more series or classes of options.

(2) – No change.

(3) In the event the bid/ask differential in the underlying security is greater than the bid/ask differential set forth in subsection (b)(1), the permissible price differential for any in-the-money option series may be identical to those in the underlying security market. In the case of the at-the-money and out-of-the-money series, two Floor Officials may waive the requirements of subsection (b)(1) on a case-by-case basis when the bid/ask differential for the underlying security is greater than .50 or 1/2 of a point. In such instances, the bid/ask differentials for the at-the-money series and the out-of-the-money series may be half as wide as the bid/ask differential in the underlying security in the primary market. Whenever in the judgment of two Floor Officials the interest of maintaining a fair and orderly market so requires, those Floor Officials may waive the requirements of subsection (b)(2) on

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<sup>2</sup> Underscoring indicates new text.

a case-by-case basis. Exemptions from subsections (b)(1) and (b)(2) are subject to Options Floor Trading Committee review.

(c) - (d) – No change.

*Commentary:*

.01 - .09 – No change.

.10 For purposes of subsection (d), two minutes shall be presumed to be a “reasonable” period of time in which to maintain a revised bid or offer. However, a revised market may be further revised before two minutes pass if the following market changes occur:

(1) A change in the market quote in the underlying security or a change in the size of the market quoted; or

(2) In the case of another option series on the same underlying security, a quote change of [1/4 of a point (or) twice the minimum price differential []] resulting from a customer order.

Two Floor Officials may grant exemption from the rule on a case-by-case basis if the individual situation warrants such action.

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**¶4987**

**“Crossing Orders”**

Rule 6.47(a) – No change.

(1) – No change.

(2) After providing an opportunity for such bids and offers to be made, he must (i) bid above the highest bid in the market by at least the MPV and give a corresponding offer at the same price or at prices differing by the minimum fraction or (ii) offer below the lowest offer in the market by at least the MPV and give a corresponding bid at the same price or at prices differing by the minimum fraction.

(3) – No change.

Rule 6.47(b) – No change.

(1) – (2) – No change.

(3) After providing an adequate opportunity for such bids and offers to be made, the Floor Broker must, on behalf of the public customer whose order is

subject to facilitation, either bid above the highest bid in the market by at least the MPV or offer below the lowest offer in the market by at least the MPV identify the order as being subject to facilitation, and disclose all terms and conditions of such order. [No change to remainder of paragraph]

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**Trading Rotations**

Rule 6.64(a)–(c) – No change.

*Commentary:*

.01 - .03(a)–(b) – No change.

(c) If eligible market and marketable limit orders can be completely satisfied by trading against other orders in the Book, then the market may open between the established bid and ask prices, with no Market Maker participation. For example, if the market is 2 - 2.25 or 2 - 2 1/4, with an order in the Book to sell 20 contracts at 2.10 or 2-1/8, and there is a market order to buy 5 contracts, the single price opening will occur with 5 contracts trading at 2.10 or 2-1/8. The opening price will always be on or between the established bid and offer.

(d) If there is no trading increment available at the half-way point between the bid and offering prices (e.g., as in the case of a market of 2 bid, 2.10 or 2-1/16 asked), then the opening price will be established at the price closest to the last sale price of option contracts in that series.

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**Trading Differentials**

Rule 6.72(a). The Exchange ~~will~~ has determine determined the minimum price variation (“MPV”) for option contracts quoted on the Exchange. For those options issues that are quoted in decimals the MPV will be:

(1) For options issues that, prior to August 28, 2000,  
were quoted under \$3.00 per contract: .05 MPV

(2) For equity issues that, prior to August 28, 2000,  
were quoted at \$3.00 per contract or greater: .10 MPV

Those options issues that continue to be quoted in fractions the MPVs will be, Bids and offers above \$3 must be expressed in eighths of one dollar (e.g., 3 1/8) and bids and offers below \$3 must be expressed in sixteenths of one dollar (e.g., 2 1/16).

This rule will govern the activity of all member and member organizations when their conduct relates to trading of issues quoted in decimals. However, this rule in no way diminishes the obligations of member and member organizations to abide by the current rules of the Exchange when their business activity relates to trading of issues quoted in fractions.

*Commentary:*

.01 The Exchange may only change the trading differentials for option contracts traded on the Exchange by filing a rule change proposal with the SEC, pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934 (effective upon filing).

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### Priority of Bids and Offers

Rule 6.75(a)-(d) – No change.

(e) Price Priority. A bid or offer will have price priority over another bid or offer only if its price exceeds the price of the other bid or offer by the MPV.

*Commentary:*

.01 – No change.

.02 The Options Floor Trading Committee has adopted the following guideline regarding orders to sell at a price of .10 or 1/16:

When an Order Book Official is displaying, pursuant to Rule 6.55, limited orders to sell at .10 or 1/16 which have priority pursuant to Rule 6.75, no Floor Broker or Order Book Official shall hold a market order to sell that series. Whenever this condition occurs, Floor Brokers and Order Book Officials shall immediately return any held orders to the member organization's floor communication station clearly marked "Market Order Unacceptable—.10 or 1/16 limit in book." The member organization initiating the order on the Floor shall immediately transmit a request for a cancellation of the market order or a change to a limit order back to the office originating the order.

.03 – No change.

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### Priority on Split Price Transactions

Rule 6.76(a) – (c) – No change.

*Commentary:*

.01 The priority afforded by this rule is effective only insofar as it does not conflict with orders on the book of the Order Book Official as provided in rule 6.75. Such orders on the book of the Order Book Official have precedence over members' orders at a particular price; orders on the book also have precedence over members' orders that are not superior in price by at least the MPV.

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### Accommodation Transactions

Rule 6.80 (i) – (vi) – No change.

*Commentary:*

.01 An Order Book Official who receives a closing buy order for \$1 per option contract shall attempt to execute the order against any \$1 closing sell orders in his possession. If any part of the buy order cannot be immediately executed the Order Book Official shall display the \$1 bid.

The Order Book Official shall effect all cabinet transactions by matching closing purchase or sale orders which have been placed in the cabinet or, provided there is no matching closing purchase or sale order in the cabinet by matching an opening purchase or sale order.

Upon receiving a closing sell order for \$1 per option contract the Order Book Official shall attempt to execute the order at the best price available. If any part of the sell order cannot be immediately executed the Order Book Official shall display the order as a \$1 per option contract offering. However, since a market or a .10 or 1/16 buy order may come to the market next, the \$1 per contract closing sell order should be filed in time sequence with any order to sell at .10 or 1/16. This provides the ability to execute the closing sell order at \$1 per contract if a \$1 per contract buy order arrives next, or at .10 or 1/16 if a market or .10 or 1/16 buy order arrives next.

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### Terms of FLEX Options

Rule 8.102 (a)-(e) – No change.

(f) Special Terms for FLEX Equity Options

(3) – No change.

(4) Exercise prices and premiums may be stated in dollar amount or percentage of the price of the underlying security, rounded to the nearest minimum tick or, in the case of exercise prices, to the nearest .10 or one-eighth of a dollar.

(5) – (4) – No change.

*Commentary:*

.01 – No change.

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### **FLEX Trading Procedures and Principles**

Rule 8.103(a) – (d) – No change.

(e) Priority of Bids and Offers. Quote priorities are based on price and time as set forth below. All transactions must be in compliance with Section 11(a) of the Securities Exchange Act of 1934 and the rules promulgated thereunder.

(1) Bids. The highest bid shall have priority, but where the two or more best bids are submitted at the same price, the bid(s) submitted first in time will have priority, and where the two or more best bids are submitted at the same time and at the same price, priority will be given to such of those bid(s) as were submitted by FLEX Appointed Market Maker(s) appointed to FLEX Index Options on that underlying index or by FLEX Qualified Market Makers appointed to FLEX Equity Options of that class.

(2) Offers. The lowest offer shall have priority, but where the two or more best offers are submitted at the same price, the offer(s) submitted first in time will have priority, and where the two or more best offers are submitted at the same time and at the same price, priority will be given to such of those offer(s) as were submitted by FLEX Appointed Market Maker(s) appointed to FLEX Index Options on that underlying index or by FLEX Qualified Market Makers appointed to FLEX Equity Options of that class.

(3) – No change.

(A) – No change.

(B) In the event that the Submitting Member has improved the BBO by at least the MPV and any other FLEX-participating member

matches the improved BBO, the Submitting Member will have priority to execute the contra side, but only to the extent of the largest of 2/3 of the trade, \$1 million Underlying Equivalent Value, or the remaining Underlying Equivalent Value on a closing transaction valued at less than \$1 million in the case of FLEX Index Options, or 25% of the trade in the case of FLEX Equity Options.

(C) In the event that the Submitting Member has improved the BBO by less than [the MPV, the Submitting Member will be deemed to have matched the BBO and will only have priority as provided in Subsection (A), above.