

**RAN-01-14**  
**February 21, 2001**

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

**FROM: Department of Regulatory Policy**

**SUBJECT: Use of the Automatic Execution System for Options  
(File No. SR-PCX-00-05)**

On February 15, 2001, the SEC partially approved an Exchange proposal to modify and clarify the PCX rules applicable to the Exchange's Automatic Execution System ("Auto-Ex") for options. The SEC did not approve the part of the filing that would allow certain broker-dealer orders to be executed on Auto-Ex, but the Exchange anticipates that the SEC will approve that change at a later date.

The SEC approved new PCX Rules that prohibit the following practices:

1. Dividing an order involving a single investment decision into multiple smaller lots for the purpose of meeting the order size requirements for Auto-Ex eligibility. Under this rule, multiple orders to trade the same option issue that are on the same side of the market (whether short or long) and multiple orders to trade the same option series entered **within any 15-second period** for the account of the same beneficial owner will be presumed to be based on a single investment decision.<sup>1</sup>
2. Entering orders via POETS to perform a market making function. Under this rule, no member or person associated with a member may use POETS on a regular and continuous basis to simultaneously execute orders to buy and sell series for the account of the same beneficial holder. In making the determination of whether a member or person associated with a member is using the POETS system to perform a market making function, the Exchange will consider the following factors: the simultaneous or near-simultaneous entry of limit orders to buy and sell the same option; and the entry of multiple limit orders at different prices in the same option series.

---

<sup>1</sup> However, multiple orders to trade the same option issue that are on the same side of the market (whether short or long) and multiple orders to trade the same option series entered *outside* of any 15-second period for the account of the same beneficial owner will be deemed to be separate investment decisions; provided, however, that no Order Entry Firm may divide up or permit an existing order to be divided up to make its parts eligible for entry into Auto-Ex.

3. Effecting transactions that constitute manipulation as provided in PCX Rule 4.6(a) and SEC Rule 10b-5. This would include, for example, the entry of orders for the sole purpose of changing the PCX's disseminated market quote.
4. Entering an order for an account that is ineligible for execution on Auto-Ex pursuant to Rule 6.87(b).

The rule change also requires that all Order Entry Firms sending orders to the PCX for execution must register with the Exchange; must provide written notice to all Users regarding the proper use of Auto-Ex; and must maintain adequate procedures and controls that will permit the Order Entry Firm to effectively monitor and supervise the entry of electronic orders by all Users. Moreover, the new rule specifically requires Order Entry Firms to monitor and supervise the entry of orders by Users to prevent the prohibited practices set forth in Rule 6.87(d). The Exchange will soon be providing Order Entry Firms with "Auto-Ex Order Entry Firm Application Agreements" to be executed and returned to the Exchange.

\* \* \*

Following is the text of the rule change that the SEC has approved. Questions regarding this Bulletin may be directed to Cindy Sink at (415) 393-7926, Peter Bloom at (415) 393-4166 or Michael Pierson at (415) 393-4107.

\* \* \*

### **Text of the Rule Change:<sup>2</sup>**

#### **¶5231**

#### **Automatic Execution System**

Rule 6.87(a). Definitions. For purposes of Rule 6:

(1) The term "Auto-Ex" means the automated execution system feature of POETS that is owned and operated by the Exchange and that provides automated order execution and reporting services for options.

(2) The term "User" means any person or firm that obtains electronic access to Auto-Ex through an Order Entry Firm.

(3) The term "Order Entry Firm" means a member organization of the Exchange that is registered as an Order Entry Firm for purposes of sending orders to the Exchange for execution by Auto-Ex.

(b) Eligible Orders.

---

<sup>2</sup> New text is underscored.

(1) [(a)] Only non-broker/dealer customer orders are eligible for execution on the Exchange's Auto-Ex System [Automatic Execution System (“Auto-Ex”)]. For purposes of this Rule, the term “broker/dealer” includes foreign broker/dealers.

(2) [(b)] The Options Floor Trading Committee (“OFTC”) shall determine the size of orders that are eligible to be executed on Auto-Ex. Although the order size parameter may be changed on an issue-by-issue basis by the OFTC, the maximum order size for execution through Auto-Ex is as follows:

(A)[(1)] Equity Options: the maximum order size for execution through Auto-Ex for equity options is one hundred (100) contracts;

(B)[(2)] Index Options: the maximum order size for execution through Auto-Ex is one hundred (100) contracts for:

(i)[(A)] – (iii)[C] – No change.

(3) [(c)] The [Options Floor Trading Committee] OFTC may increase the size of Auto-Ex eligible orders in one or more classes of multiply traded equity options to the extent that other exchanges permit such larger-size orders in multiply traded equity options of the same class or classes to be entered into their own automated execution systems. If the [Options Floor Trading Committee] OFTC intends to increase the Auto-Ex order size eligibility pursuant to this Rule, the Exchange will notify the Securities and Exchange Commission pursuant to Section 19(b)(3)(A) of the Exchange Act.

(c) Order Entry Firm Registration. Participation in Auto-Ex as an Order Entry Firm requires registration with the Exchange. Continued registration depends upon the Order Entry Firm’s initial and continuing compliance with the following requirements:

(1) execution of an Auto-Ex Order Entry Firm Application Agreement with the Exchange;

(2) compliance with all applicable PCX options trading rules and procedures;

(3) written notice must be provided to all Users regarding the proper use of Auto-Ex; and

(4) maintenance of adequate procedures and controls that will permit the Order Entry Firm to effectively monitor and supervise the entry of electronic orders by all Users. Order Entry Firms must monitor and supervise the entry of orders by Users to prevent the prohibited practices set forth in subsection (d).

(d) Prohibited Practices. Prohibited practices include, but are not limited to, the following:

(1) Entering an order for an account that is ineligible for execution on Auto-Ex pursuant to subsection (b), above.

(2) Dividing an order involving a single investment decision into multiple smaller lots for the purpose of meeting the order size requirements for Auto-Ex eligibility.

(A) Multiple orders to trade the same option issue that are on the same side of the market (whether short or long) and multiple orders to trade the same option series entered *within* any 15-second period for the account of the same beneficial owner will be presumed to be based on a single investment decision.

(B) Multiple orders to trade the same option issue that are on the same side of the market (whether short or long) and multiple orders to trade the same option series entered *outside* of any 15-second period for the account of the same beneficial owner will be deemed to be separate investment decisions; provided, however, that no Order Entry Firm may divide up or permit an existing order to be divided up to make its parts eligible for entry into Auto-Ex.

(3) Entering orders via POETS to perform a market making function as provided in Rule 6.88(c).

(4) Effecting transactions that constitute manipulation as provided in PCX Rule 4.6(a) and SEC Rule 10b-5.

[(d) Firms entering orders for execution on Auto-Ex may not divide them up in order to make their parts eligible for entry into Auto-Ex.]

(e) - (k) – [(d) – (j)] – No change.

\* \* \*

### **POETS**

**¶ 5231D**

### **Pacific Options Exchange Trading System**

Rule 6.88 (a) – (b) – No change.

(c) Entering orders via POETS to perform a market making function is prohibited. No member or person associated with a member may use POETS on a regular and continuous basis to simultaneously execute orders to buy and sell series for the account of the same beneficial holder. In making the determination of whether a member or person associated with a member is using the POETS system to perform a market making function, the Exchange will consider the following factors: the simultaneous or near-simultaneous entry of limit orders to buy and sell the same option; and the entry of multiple limit orders at different prices in the same option series.