



RULE  
ADOPTION  
NOTICE

**RAN-05-46**  
**June 9, 2005**

**TO: All OTP Holders and OTP Firms**

**FROM: Department of Regulatory Policy**

**SUBJECT: Exchange Calculation of the NBBO when Another Market Is Disconnected from the Intermarket Option Linkage (File No. SR-PCX-2005-27)**

On March 31, 2005, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change to amend the PCX Rules 6.87 and 6.94 to change the way the National Best Bid or Offer Calculation is made when another market is disconnected from the Intermarket Option Linkage. The Exchange filed Amendment No. 1 to the proposed rule change on April 19, 2005. The proposed rule change was approved by the Commission on June 7, 2005.

The following is the text of the rule change. Questions regarding this bulletin may be directed to Steven B. Matlin at (415) 393-4084.

**EXHIBIT 5**  
**Text of the Proposed Rule Change:<sup>1</sup>**

**Rules of the  
Pacific Exchange, Inc.**

**Rule 6**

[Rule 6.87(h)(4) Declaring Away Markets Unreliable. When the Exchange determines that quotes from one or more particular markets in one or more options series are not reliable, the Exchange may direct the senior person in charge of the Exchange's control room to exclude the unreliable quotes from the Auto-Ex determination of the NBBO in the particular options series.

(A) Determining Unreliability. The Exchange may determine that quotes in one or more particular options classes in a market are not reliable only under the following circumstances:

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<sup>1</sup> New text is underscored; deleted text is in brackets.

(i) A market's quotes in a particular options class are not firm based upon direct communication to the Exchange from the market or the dissemination through OPRA of a message indicating that disseminated quotes are not firm; or

(ii) A market has directly communicated to the Exchange or otherwise confirmed that the market is experiencing systems or other problems affecting the reliability of its disseminated quotes.

(B) *Procedures to Follow.* If one of the factors set forth in subsection (4)(A) occurs, then the following procedures must be followed.

(i) First, an LMM contacts an Order Book Official ("OBO") and requests that the away market be declared unreliable.

(ii) Second, the OBO contacts the control room and requests that the control room confirm with the away market that it is unreliable pursuant to subsection (4)(A).

(iii) Third, if the control room has confirmed that an away market is unreliable, then the OBO will contact the Exchange and request a declaration that the away market is unreliable.

(iv) Fourth, the Exchange reviews and verifies the circumstances and determines whether away market should be declared unreliable. The OBO notifies the control room that the away market is unreliable and should be removed from the NBBO calculation.

(v) Fifth, the Floor Surveillance Unit ("FSU") contacts the away exchange, and notifies the away market that one or more of its quotes have been removed from the NBBO calculation.

(vi) Sixth, the Exchange will continue to monitor the away market that has been declared unreliable and notify the control room to return to firm mode when appropriate.

(C) *Documentation Required.* The following documentation is required when an away market is declared unreliable.

(i) The OBO must log the issue(s) and time of the LMM's request for a declaration that the away market was unreliable.

(ii) The OBO must prepare an Unusual Activity Report ("UAR") documenting the facts giving rise to the LMM's request, the date, time, and duration of the exclusion and the reasons for placing the away market back into the NBBO calculation.

(iii) The Exchange Official must sign the UAR.

(iv) The control room will maintain a log of the time the away market was taken out of the NBBO calculation and the time that the away market was placed back into the

NBBO calculation.

(D) *Duration of the Declaration.* Any determination to exclude a market or any of its quotes from the Auto-Ex determination of the NBBO pursuant to subsections (4)(A)(i) or (ii) will expire at the end of the trading day, or at the time that the quotes are confirmed by the market to be reliable again, whichever occurs first. Exclusion of a market or its quotes from the Auto-Ex determination of the NBBO will be reported to Exchange member firms.]

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Rule 6.94(e) Declaring Away Markets Unreliable. When the Exchange determines that quotes from one or more particular markets in one or more options series are not reliable, the Exchange may direct the senior person in charge of the Exchange's control room to exclude the unreliable quotes from the determination of the NBBO in the particular options series.

(A) Determining Unreliability. The Exchange may determine that quotes in one or more particular options classes in a market are not reliable only under the following circumstances:

(i) A market's quotes in a particular options class are not firm based upon direct communication to the Exchange from the market or the dissemination through OPRA of a message indicating that disseminated quotes are not firm;

(ii) A market has directly communicated to the Exchange or otherwise confirmed that the market is experiencing systems or other problems affecting the reliability of its disseminated quotes; or

(iii) A market has been disconnected from Linkage.

(B) Procedures to Follow. If either of the factors set forth in subsection (A)(i) or (ii) above occurs, then the procedures in (i) – (vi) below must be followed. If the factor set forth in subsection (A)(iii) above occurs, then the procedure in (vii) below must be followed.

(i) First, an LMM contacts an Order Book Official ("OBO") and requests that the away market be declared unreliable.

(ii) Second, the OBO contacts the control room and requests that the control room confirm with the away market that it is unreliable pursuant to subsection (A).

(iii) Third, if the Control Room has confirmed that an away market is unreliable, then the OBO will contact the Exchange and request a declaration that the away market is

unreliable.

(iv) Fourth, the Exchange reviews and verifies the circumstances and determines whether away market should be declared unreliable. The OBO notifies the Control Room that the away market is unreliable and should be removed from the NBBO calculation.

(v) Fifth, the Floor Surveillance Unit ("FSU") contacts the away market, and notifies the away market that one or more of its quotes have been removed from the NBBO calculation.

(vi) Sixth, the Exchange will continue to monitor the away market that has been declared unreliable and notify the Control Room to return to firm mode when appropriate.

(vii) The senior person in charge of the Control Room will direct that the unavailable away market be declared unreliable and removed from the NBBO calculation until the sooner of the end of the trading day, or at the time that the quotes are confirmed by the Exchange to be reliable again.

(C) Documentation Required. The following documentation is required when an away market is declared unreliable. If either of the factors set forth in subsection (A)(i) or (ii) above occurs, then the procedures in (i) – (iv) below must be followed. If the factor set forth in subsection (A)(iii) above occurs, then the procedure in (v) below must be followed.

(i) The OBO must log the issue(s) and time of the LMM's request for a declaration that the away market was unreliable. This provision does not apply if an away market is declared unreliable because a market has been disconnected from Linkage.

(ii) The OBO must prepare an Unusual Activity Report ("UAR") documenting the facts giving rise to the LMM's request, the date, time, and duration of the exclusion and the reasons for placing the away market back into the NBBO calculation. This provision does not apply if an away market is declared unreliable because a market has been disconnected from Linkage.

(iii) The Exchange Official must sign the UAR.

(iv) The Control Room will maintain a log of the time the away market was taken out of the NBBO calculation and the time that the away market was placed back into the NBBO calculation.

(v) When an away market is declared unreliable because it has been disconnected from Linkage, the Control Room will document a UAR and the UAR must be signed by an Exchange Official.

(D) Duration of the Declaration. Any determination to exclude a market or any of its quotes from the determination of the NBBO pursuant to subsections (A)(i), (ii) or (iii) will expire at the sooner of the end of the trading day, or at the time that the quotes are confirmed by the Exchange to be reliable again. Exclusion of a market or its quotes from the determination of the NBBO will be reported to Exchange OTP Holders and OTP Firms.

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