

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-51937; File No. SR-PCX-2005-31)**

**June 29, 2005**

**Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendments No. 1, 2, and 3 Thereto to Permit Lead Market Makers to Operate from a Remote Location**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 15, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange submitted Amendments No. 1, 2, and 3 on May 27, 2005,<sup>3</sup> June 6, 2005,<sup>4</sup> and June 22, 2005,<sup>5</sup> respectively. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

**I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change**

The PCX is proposing to amend PCX trading rules in order to allow OTP Holders and OTP Firms who conduct Lead Market Making activity to do so whether on the

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 makes clarifying changes to the purpose statement and rule text. Amendment No. 1 replaces the original rule filing in its entirety.

<sup>4</sup> Amendment No. 2 makes a technical correction to the rule text in Exhibit 5.

<sup>5</sup> Amendment No. 3 clarifies how a Lead Market Maker will garner their guaranteed trade allocations the PCX by adding the words “via the PCX Plus system” at the end of the second paragraph in the purpose statement. Amendment No. 3 also eliminates the deletion of PCX Rule 6.37(f)(1).

trading floor or from a remote location. The text of the proposed rule change is set forth below. Additions are in italics; deletions are in brackets.

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

**Rule 6**

**Options Trading**

Rule 6.32(a). A Market Maker is an individual who is registered with the Exchange for the purpose of making transactions as a dealer-specialist on the Floor of the Exchange or, in the case of a Remote Market Maker or a Lead Market Maker, through the facilities of the Exchange in accordance with the provisions of this subsection. Registered Market Makers are designated as specialists on the Exchange for all purposes under the Securities Exchange Act of 1934 and the Rules and Regulations thereunder. Except as provided in subsection (c) below, only transactions that are initiated on the Floor of the Exchange or executed through the facilities of the Exchange [by a Remote Market Maker] will count as Market Maker transactions for the purposes of Rule 6.32. A Market Maker on the Exchange must be either a Lead Market Maker, a Remote Market Maker, a Supplemental Market Maker, or a Floor Market Maker.

(1) A Lead Market Maker is a registered Market Maker who makes transactions as dealer-specialist [while] on [the Floor of] the Exchange and who meets the qualification requirements of Rule 6.82(b).

(2) – (4) – No change

(b) Market Makers and Floor Brokers effecting transactions as Market Makers are instructed that, except as specified in subsection (c) below, only transactions that are

initiated on the Floor of the Exchange or[, in the case of a Remote Market Maker,] through the facilities of the Exchange by that person shall count as Market Maker transactions and be entitled to special margin treatment, pursuant to the net capital requirements of Rule 15c3-1 under the Securities Exchange Act of 1934 and Regulation T of the Board of Governors of the Federal Reserve system. Accordingly, any position established for the account of a Market Maker [other than a Remote Market Maker] which has been “entered [from off the floor] through an OTP Firm acting as a Floor Broker” must be placed in the Market Maker’s investment account and be subject to applicable customer margin.

(c) A Market Maker may enter opening orders from off the Floor of the Exchange for execution by Floor Brokers and receive special margin treatment for such orders during any calendar quarter, provided that such Market Maker executes in person or through a facility of the exchange, and not through the use of orders, at least 80% of his or her total transactions during that calendar quarter. This provision, if applicable, shall supersede the 60% in-person requirement of Rule 6.37. In addition, the [off-floor] orders executed by a Floor Broker for which a Market Maker received market-maker treatment shall be consistent with a Market Maker’s duty to maintain fair and orderly markets and in general shall be effected for the purpose of hedging, reducing the risk of, or rebalancing open positions of the Market Maker. Remote Market Makers may enter opening orders from off the Floor of the Exchange for execution by Floor Brokers and receive special margin treatment for them as long as the entry of such orders is consistent with the Remote Market Maker’s duty to maintain fair and orderly markets and such orders are entered for the purpose of hedging, reducing the risk of, or rebalancing open positions of

the Remote Market Maker.

(d) – (e) – No change

Rule 6.33 – 6.35(h)(3) – No Change.

Rule 6.35(h)(4) at no time will a Remote Market Maker concurrently trade or quote the same option issue as a Remote Market Maker or Lead Market Maker who is a Nominee for the same OTP Holder or OTP Firm.

Rule 6.36(a). Required of Each OTP Holder. No Market Maker may make any transaction on the floor of the Exchange or, in the case of a Remote Market Maker or a Lead Market Maker, through the facilities of the Exchange unless there is in effect a Letter of Guarantee which has been issued for such OTP Holder or OTP Firm by a Clearing Member and approved by the Options Clearing Corporation and the Exchange. An OTP Holder or OTP Firm may not have more than one such Letter in effect at the same time except for the purpose of facilitating the transfer of that OTP Holder or OTP Firm's Market Maker account from one Clearing Member to another or unless the Exchange determines otherwise.

Rule 6.36(b) – 6.37(c) – No Change.

Rule 6.37(d) In-Person Requirements for Market Makers [(other than Remote Market Makers who are not present on the Trading Floor)]. In order to meet the obligations of this rule, and in the interest of a fair and orderly market, an adequate number of Market Makers must be available throughout each trading session. In acknowledgement thereof, the following minimum in-person trading requirements shall be in effect: At least 60% of a Market Makers transactions must be executed by the Market Maker in-person or through an approved facility of the exchange [, while he is present on the Options

Trading Floor of the Exchange]. Orders executed for a Market Maker through a Floor Broker will not be credited toward the 60% requirement. A failure to comply with this 60% in-person trading requirement may result in a fine pursuant to Rule 10.13; however, if aggravating circumstances are present, formal disciplinary action may be taken pursuant to Rule 10.4.

Rule 6.37(e) – Rule 6.37 Commentary .02 – No Change

Rule 6.37 Commentary .03(a) – When a Market Maker other than a Remote Market Maker or a Lead Market Maker operating from off the trading floor, displays a market on the screen that is the best market in that crowd, the Market Maker is obligated to ensure that its market is removed from the screen when the Market Maker leaves the crowd.

Rule 6.37 Commentary .04 - Rule 6.81 – No Change

Rule 6.82(a). General Provisions

(1) Lead Market Maker Defined. A Lead Market Maker (“LMM”) is an individual or entity that has been deemed qualified by the Exchange [Options Allocation Committee] for the purpose of making transactions on [the Options Floor of] the Exchange in accordance with the provisions of Rule 6.82. Each LMM or nominee thereof must be registered with the Exchange as a Market Maker. Any OTP Holder or OTP Firm registered as a Market Maker with the Exchange is eligible to be qualified as an LMM. [Remote Market Makers are not eligible to act as LMMs from a location off the trading floor.]

Rule 6.82(a)(2) – (c)(4) – No Change.

Rule 6.82(c)(5) Be [present at the trading post] accessible throughout every business day and, in addition, designate an approved LMM to act as a back-up LMM and notify Book Staff of such designation;

Rule 6.82(c)(6) – (g) – No Change.

Rule 6.82(h)(1) – Reserved. [LMM Performance of Order Book Official Functions.

(a) The LMM may, subject to the approval of the Exchange, perform all functions of the Order Book Official (“OBO”) in designated option issues pursuant to Rules 6.51 through 6.59.

(b) The Exchange shall make personnel available to assist the LMM as the LMM shall reasonably require in performing the OBO function. The Exchange may charge the LMM a reasonable fee for such use of Exchange personnel.

(c) Subject to the review of two Trading Officials or the Exchange, the LMM shall resolve trading disputes upon request of any party to such dispute.

(d) The LMM shall disclose Book information to OTP Holders or OTP Firms upon request, pursuant to Rule 6.57.

(e) If the Exchange decides to reallocate an issue to the Market Maker system pursuant to Section (f)(2) of this Rule, the terminated LMM may receive a share of the net Book revenues, not to exceed one-half, for any period specified by the Exchange up to a maximum of five years. Such award shall take into account the length of time of LMM service, the LMM’s capital commitment, efforts expended as LMM and any other relevant factors.]

Rule 6.82(h)(2) – (h)(3) – No Change.

Commentary:

.01 It shall be the duty of the Exchange to promulgate and recommend to the Board of Directors rules and policies with regard to the [Options Floor] trading activities of the LMM.

[.02 LMMs who perform the function of an Order Book Official pursuant to Rule 6.82(h) shall maintain “minimum net capital” as provided in SEC Rule 15c3-1, and shall also maintain a cash or liquid asset position of at least \$500,000, plus \$25,000 for each issue over 5 issues for which they perform the function of Order Book Official.]

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Rule 7.1. Unless otherwise ruled by the Board of Directors, the Exchange shall be open for the transactions of business daily except on Saturdays and Sundays. The hours at which trading sessions shall open and close shall be established by the Board of Directors.

Dealings upon the Exchange shall be limited to the hours during which the Exchange is open for the transaction of business. No OTP Holder or OTP Firm shall make any bid, offer or transaction upon the Floor or in the case of Remote Market Makers or Lead Market Makers operating from off the Floor, through the facilities of the Exchange before the official opening of the Exchange and loans of securities may be made after those hours.

Commentary:

.01 The Board of Directors has resolved that transactions may be effected on the Options Floor of the Exchange or in the case of Remote Market Makers or Lead Market Makers operating from off the Floor, through the facilities of the Exchange until 1:02 p.m. for equity options and until 1:15 p.m. for index options at which time no further transactions may be made.

.02 – No Change.

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## **II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

### **A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

#### **1. Purpose**

The purpose of the proposed filing is to modify the Exchange trading rules in order to allow OTP Holders and OTP Firms who conduct Lead Market Making activity to do so whether on the trading floor or from a remote location. Currently, the PCX rules require a Lead Market Maker be physically present on the trading floor in order to conduct Lead Market Maker activities. With the roll out of PCX Plus, the Exchange’s electronic trading system, the Exchange seeks to introduce a platform by which Lead Market Makers may either be present on the trading floor or may serve their role from a remote location.

To permit a Lead Market Maker to work from remote locations, the Exchange is proposing to modify its trading rules to remove the current restrictions that require a Lead Market Maker to be physically present on the trading floor. The proposed changes will not affect any rights of the Lead Market Maker. They will retain their guaranteed participation allowances and opportunities to participate in open outcry should they choose to work from

the physical trading floor. For those Lead Market Makers who choose to conduct their business from remote locations, they will not be able to inure the benefits of the current open outcry strategies and will be granted their guaranteed participation rights solely based upon the size and price that they disseminate via the PCX Plus System.

In order to allow Lead Market Makers to operate from a remote location, the Exchange is proposing a number of changes to its Rules. First, PCX Rule 6.32 is being amended to add Lead Market Makers to the definition of who may make transactions through the facilities of the Exchange. This change will allow Lead Market Makers who are not physically present on the trading floor to perform the duties and obligations from a remote location. Language in PCX Rule 6.32 is also being changed to allow for trades executed by a Lead Market Maker through a facility of the Exchange, in addition to in-person trades, to be eligible to receive market maker margin. Presently only Lead Market Maker trades that are executed on the floor of the Exchange or those that meet the criteria of PCX Rule 6.32(c) are eligible for market maker margin. Under the proposal, a Lead Market Maker acting from a remote location would still be required to meet all of the obligations of a Lead Market Maker as stated in PCX Rule 6.82 and therefore the PCX believes such LMMs should be entitled to market maker margin on all qualified trades.

Second, the Exchange is proposing to eliminate the prohibition in PCX Rule 6.82(a)(1) that Remote Market Makers are not eligible to act as Lead Market Makers from a location off the trading floor. This change is necessary to permit Lead Market Makers to operate from a remote location and to eliminate any uncertainty that may exist in interpreting PCX Rules. A firm that operates at the PCX can have different employees who function as Remote Market Makers and Lead Market Maker, however under the

proposed new rules these individuals are prohibited from trading the same option issues.<sup>6</sup> Without eliminating this restriction, PCX Rule 6.82(a)(1) would prohibit a PCX firm from having different employees functioning as both a Remote Market Maker and a Lead Market Maker from off the trading floor. Firms would be only allowed to have an employee in one of these categories and thus this would restrict a firm's ability to operate remotely and in turn reduce the amount of liquidity available to the PCX markets.

Fourth, as part of allowing Lead Market Makers to operate from a remote location, the Exchange is proposing to eliminate PCX Rule 6.82(h)(1). This rule currently allows the Lead Market Maker to perform Order Book Official functions. Since an Order Book Official is only present on the trading floor (PCX Plus does not contain a functionality similar to that which is performed by an Order Book Official), this function is not needed should a Lead Market Maker choose to operate from a remote location. The Exchange represents that at this time no Lead Market Maker is currently performing the functions of an Order Book Official nor has any Lead Market Maker expressed an interest in doing so. The Exchange further represents that for those individuals who continue to trade via open outcry on the trading floor, the Exchange will provide the necessary staff to effectively supervise trading.

Finally, the Exchange notes that provisions of the PCX Rules that permit Lead Market Makers to perform certain functions that require them to be physically present on the trading floor (i.e. PCX Rule 6.82(h)(3)) will only be permitted should the Lead Market Maker remain physically present on the trading floor. These functions will not be permitted should the Lead Market Maker decide to operate from a remote location.

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<sup>6</sup> See Proposed PCX Rule 6.35(h)(4).

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>8</sup> in particular, because it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of change, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change, as amended, will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

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<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

- (A) by order approve such rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an E-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-PCX-2005-31 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission/Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-PCX-2005-31. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule

change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of such filing also will be available for inspection and copying at the principal office of the PCX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-PCX-2005-31 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

Margaret H. McFarland,  
Deputy Secretary

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<sup>9</sup> 17 CFR 200.30-3(a)(12).