

Regulatory Circular 01-107

Date: **July 10, 2001**

To: **All Members and Member Organizations**

From: **Department of Market Regulation**

Re: **Audit Trail Violations**

The purpose of this Regulatory Circular is to inform members and member organizations that on September 6, 2000, and March 7, 2001, the Securities and Exchange Commission ("SEC") approved amendments to Exchange Rule 6.51 – Reporting Duties, and Exchange Rule 17.50 – Imposition of Fines for Minor Rule Violations.

KEY ISSUES

Exchange Rule 6.51(a) has been amended in the following manner:

- A participant in each option transaction designated by the Exchange must report or ensure the transaction is reported to the Exchange within ninety (90) seconds of execution. Transactions not reported within 90 seconds after execution shall be designated as late. All options and securities exchanges' rules require the same 90-second trade reporting.
- A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with just and equitable principles of trade and subject to summary fine under Exchange Rule 17.50 or to discipline by the Business Conduct Committee.
- The Exchange is initiating enforcement of the 90-second trade reporting requirement with a period of member education, including providing monthly advisory letters to members whose trade reporting appears deficient under the new standard. Such notices have been issued monthly since January 2001.

Exchange Rule 17.50 has been amended in the following manner:

- Fines will be imposed under Rule 17.50(g)(4) according to the number of "offenses" committed during any rolling eighteen-month period. An "offense" for purposes of Rule 17.50(g)(4) is defined as an instance in which a pattern or practice of late reporting or failure to report without exceptional circumstances has been determined. The fine amounts are identical to the amounts imposed previously for failure to submit accurate trade information: 1st offense \$100; 2nd offense \$250; subsequent offenses \$500.
- In the event that a CBOE system error results in a late report or a failure to report, or a late report is a result of a multi-party or complex spread transaction, such facts will be considered in determining whether an exceptional circumstance exists for purposes of Rule 17.50(g)(4).

DISCUSSION

On September 6, 2000, effective March 7, 2001, the SEC approved amendments to Exchange Rule 6.51, which sets forth the trade reporting duties of members. The SEC required all of the options exchanges to adopt a rule requiring that options transactions be reported within 90 seconds of execution for purposes of time and sales reporting. Accordingly, Exchange Rule 6.51(a) has been amended to require that a participant in each option transaction designated by the Exchange must report or ensure the transaction is reported to the Exchange within 90 seconds of execution.¹ Any option transaction, which is not reported within 90 seconds after execution, shall be designated as late and will be considered a violation of Exchange Rule 6.51. A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with just and equitable principles of trade and subject to summary fine under Exchange Rule 17.50 or to discipline by the Business Conduct Committee.

On March 7, 2001, the SEC approved amendments to Exchange Rule 17.50, which sets forth the Exchange's minor rule violation fine plan. In accordance with the amendments to Rule 6.51, Rule 17.50 has been amended to: (i) consolidate the fine schedules for failure to submit accurate trade information under Rule 17.50(g)(4) and failure to submit trade information to the price reporter under Rule 17.50(g)(5) into one fine schedule under Rule 17.50(g)(4); (ii) provide that a fine shall be imposed under Rule 17.50(g)(4) upon a Market-Maker or Floor Broker who fails to submit trade information in accordance with Rule 6.51; and (iii) provide that fines will be imposed under Rule 17.50(g)(4) according to the number of "offenses" committed during any rolling eighteen month period. An "offense" for purposes of Rule 17.50(g)(4) is defined as an instance in which a pattern or practice of late reporting or failure to report without exceptional circumstances has been determined. A first offense will incur a fine amount of \$100, a second offense will incur a \$250 fine, and subsequent offenses will incur a \$500 fine. These fine amounts are identical to the fine amounts imposed previously for failure to submit accurate trade information under former Rule 17.50(g)(4).

Rule 17.50 has also amended to provide that members who are served with a written statement in accordance with Rule 17.50(b) may request verification of the fine imposed within fifteen (15) days after the date of service of the written statement. In addition, Exchange policy has been modified to provide that the fact that a transaction time is inaccurately keypunched by a keypunch operator due to illegible handwriting on an order ticket shall be no defense to the imposition of a fine under Rule 17.50(g)(4).

Rules 17.50(g)(4) is the specific provision of Rule 17.50 which provides for the imposition of fines under the Exchange's minor rule violation fine plan for failure to submit trade information on time and for failure to submit trade information to the price reporter. The following guidelines reflect Exchange policy with respect to the application of Rule 17.50(g)(4) (incorporating the amendments to Rule 17.50, which are now effective).

¹ Notice of the approved rule changes was published in the April 13, 2001 Regulatory Bulletin. The Exchange has begun enforcement of the new 90-second reporting requirement with a period of member education, during which time, the Exchange's Business Conduct Committee is reviewing both the operational aspects and sanction levels contained in the program. Beginning with the January 2001 review period, members whose reporting is deficient under the new standard are being advised in writing of the applicable summary fine. During this interim educational period, the Exchange is continuing to assess summary fines for trade reporting violations where 20% or more of a member's reported sell transactions fail to include a time that matches within five minutes of the price reporting time or the contra-party's time, or where 30% or more of a member's sell transactions are not reported. It is expected that members will use this period of advance notice of reporting deficiencies to take the steps necessary to report trades within the 90-second requirement.

A. Rule 17.50(g)(4) - Failure to Submit Trade Information On Time and Failure to Submit Trade Information to the Price Reporter.

(1) ***The Rule.***

A fine shall be imposed upon a Market-Maker or Floor Broker who fails to submit trade information in accordance with Rule 6.51. Such fines shall be imposed on the basis of the following schedule:

<i>Number of Offenses</i>	<i>in any Rolling Eighteen-Month Period</i>	<i>Fine Amount</i>
1 st Offense	\$100
2 nd Offense	\$250
Subsequent Offenses.....	\$500

An “Offense” for purposes of Rule 17.50(g)(4) means an instance in which a pattern or practice of late reporting or failure to report without exceptional circumstances has been determined.

(2) ***Exceptions.***

(i) In the event that a CBOE system error results in a late report or a failure to report, such fact will be considered in determining whether an exceptional circumstance exists.

(ii) In the event that a late report is a result of a multi-party or complex spread transaction, such fact will be considered in determining whether an exceptional circumstance exists.

(3) ***Illegible Handwriting Is No Defense.*** The fact that a keypunch operator may have incorrectly keypunched a transaction time submitted by a Market-Maker or Floor Broker due to illegible handwriting on an order ticket shall be no defense to the imposition of a fine under this Rule.

B. Right to Contest.

(a) ***Verification Request.*** Any member against whom a fine is imposed pursuant to Rule 17.50(g)(4) may request verification of the fine pursuant to Interpretation and Policy .02 to Rule 17.50. Effective March 7, 2001, Interpretation .02(a) to Rule 17.50 requires that the Exchange attempt to serve members fined pursuant to Rule 17.50(g)(4) with the written statement in accordance with Rule 17.50(b) within the month immediately following the month in which the violations were alleged to have occurred. The time period within which members served may request verification of the fine imposed is fifteen (15) days after the date of service of the written statement.

Notwithstanding the provisions of Interpretation and Policy .02(a), Interpretation and Policy .02(b) sets forth a cap on the number of transactions during a particular month with respect to which a member fined pursuant to Rule 17.50(g)(4) may request verification. Such cap shall be imposed pursuant to the following schedule:

<i>Number of Offenses</i>	<i>Maximum Number of Transactions During a Particular Month with Respect to Which Verification May Be</i>
.....

<i>Within a Rolling Eighteen Month Period</i>	<i>Requested</i>
1-2	No Limit
3+	The greater of (i) 50 transactions or (ii) 10% of the number of transactions deemed not to be in compliance with Rule 17.50(g)(4).

(b) ***Appeal.*** In addition to the right to request verification, any member against whom a fine is imposed pursuant to Rule 17.50(g)(4) may contest the fine before the Exchange's Business Conduct Committee in accordance with the provisions of Rule 17.50(c).

(c) ***Verification Request and Appeal Procedures.*** Please be advised that members wishing to request verification of, and/or contest, fines imposed pursuant to Rule 17.50(g)(4) must comply with the deadlines and all of the other procedural requirements set forth, respectively, in Interpretation and Policy .02 to Rule 17.50 and Rule 17.50(c). In connection therewith, members who wish to request verification of, and/or contest, fines imposed pursuant to Rule 17.50(g)(4) are advised to consult the specific provisions of Interpretation and Policy .02 to Rule 17.50 and Rule 17.50(c).

Any questions in connection with this circular should be directed to Joanne Heenan (312-786-7786) or Pat Cerny (312-786-7722) of the Department of Market Regulation.