

Regulatory Circular RG97-124

Date: September 25, 1997

To: Members and Member Organizations

From: Regulatory Services Division

Re: Marking Options

Marking includes, but is not limited to, the act of changing the final disseminated price or the disseminated bid/ask quote of an option series for the purpose of influencing the mark-to-the-market value of the option or to reflect a price which is not representative of the true state of the market. In addition, unauthorized use of quotron terminals to disseminate the final price or bid/ask quote of an option series may constitute marking activity. Furthermore, marking through the submission of fictitious transactions may constitute fraud and violations of Exchange and Securities and Exchange Commission rules. Marking is a form of manipulation and thus, is a violation of Exchange Rule 4.7(a)—**Manipulation**. Additionally, marking is conduct which is inconsistent with just and equitable principles of trade in violation of Exchange Rule 4.1—**Just and Equitable Principles of Trade** and Exchange Rule 8.7—**Obligations of a Market-Maker** in that it is inconsistent with a market-maker's affirmative obligations. Further, marking may also constitute a violation of Sections 9(a)(2)—**"Prohibition against Manipulation of Security Prices"** and 10(b)—**"Regulation of the Use of Manipulative and Deceptive Devices"** of the Securities Exchange Act of 1934, and Rule 10b-5—**"Employment of Manipulative and Deceptive Devices"** thereunder. In appropriate cases, the Exchange may charge violations of the federal securities laws listed above. Members should also be aware that because marking is a violation of the federal securities laws, the SEC and the Justice Department could exercise their jurisdiction and pursue an action.

It should be noted that the Regulatory Services Division recognizes that trade activity or quote changes near the end of the day are not by themselves improper. Additionally, in its analysis of possible marking activity the Division takes into consideration the equity impact of the last sales, the relative change in price from the previous trade, the concurrent underlying stock price, degree and direction of price movement, whether the last sales appear to have filled customer orders, whether a pattern of unexplained activity is apparent, and other relevant information. The Department of Market Regulation conducts reviews on a routine basis to identify quote changes and trading activity possibly effected for the purpose of influencing option mark-to-the-market values and will refer all possible marking violations to the Business Conduct Committee for disciplinary action. Also, marking activity by members of a trading crowd will be taken into consideration by the Market Performance Committee when evaluating a trading crowd's performance and may result in remedial action being taken by the Market Performance Committee under Exchange Rule 8.60—**Evaluation of Trading Crowd Performance**, notwithstanding any action taken by the Business Conduct Committee. The Committees believe it is in the best interest of all members, market-makers and floor brokers alike, to ensure that the credibility of our marketplace is not compromised due to the marking of options.

The Exchange has expended considerable time and effort to improve and build relations with our customers. Members should be aware that marks which occur between the bid and offer and which are as small as 1/16 can have a significant impact on the valuation of the accounts of all market participants holding positions in the affected series by changing the amount of margin or capital required to maintain the positions as well as the equity of the account. The Business Conduct Committee and the Market Performance Committee are concerned that marking options prices is not only a serious violation of Exchange Rules, but also detrimental to the credibility of our marketplace. The Exchange by this notice is advising members that it intends to recommend increased sanction levels for those who engage in marking activity.

Questions concerning this matter may be directed to Joanne Heenan at (312) 786-7786 or Margaret Williams at (312) 786-7834.