

Regulatory Circular 95-24

Date: March 13, 1995

To: Members and Member Organizations

From: Regulatory Services Division

Re: Options Market-Maker Limited Exemption to the NASD Short Sale Rule

The SEC has recently approved changes to Exchange Rule 15.10 expanding the applicability of the options market-maker exemption to the NASD short sale rule. The initial exemption is described in Regulatory Circular RG94-64, dated September 2, 1994. Briefly, the changes are as follows: The exemption is now applicable to the stocks underlying *all* classes in one's appointment, not just those traded at three stations; there is limited ability for nominees of the same organization to apply the exemption in each other's eligible classes; the exemption can in some instances be applied to stocks involved in a merger or acquisition; and the exemption can in some instances be applied in order to accommodate the execution of orders originating from off-floor in classes outside one's appointment. The new provisions are explained in detail below.

The exemption applies to all classes in an appointment. Members no longer need to identify stations in which they wish to apply the exemption.

Nominees of the same member organization: A market-maker nominee may utilize the exemption in a Nasdaq/NMS security which does not underlie a class in his/her appointment provided that such security does underlie a class within the appointment of another nominee, if such other nominee is not also present on the floor or represented by a floor broker in the applicable trading crowd at the time of the bid test exempt sale. In other words, a market-maker nominee may rely on the fact that another nominee(s) has a given class in their appointment as long as such other nominee(s) are not also present on the floor or represented in the applicable trading crowd via order.

Companies involved in mergers and/or acquisitions: The exemption can be extended to the sale of stock of a company if it is involved in a publicly announced

merger or acquisition of a company whose stock underlies a class in one's appointment, and such sale is made to hedge existing or prospective positions in such class of options. For example, if a market-maker has an appointment in class ABC and company ABC is the subject of a prospective publicly announced merger or acquisition by company XYZ (the stock of which is a Nasdaq/NMS security), then the exemption can be applied to sales of XYZ stock provided that they legitimately hedge options positions in class ABC.

Short sales to hedge certain trades outside one's appointment: The exemption can be extended outside stocks underlying appointed classes for the purpose of hedging trades which accommodate the execution of options or combination orders originating from off-floor. The order must originate from off-floor, but may be for the account of a customer, market-maker or other broker-dealer. The following procedures must be adhered to:

- 1) prior notification must be made to a Floor Official or Order Book Official,
- 2) the exempt short sale must be contemporaneous with the trade with the off-floor order,
- 3) the Floor Official or Order Book Official must file a report describing the transaction, giving a copy to the market-maker, and
- 4) the market-maker must maintain a copy of this report as his record that the sale of the stock was bid/test exempt.

The report shall contain a description of all relevant stock and option trades, including volumes, prices, and the time(s) of the trades, and shall identify the member firm representing the order originated from off-floor and the acronym of the Floor Broker executing such order. Floor Officials or Order Book Officials shall use standard Floor Official or OBO UAR forms for purposes of filing the reports. The reports will then be forwarded to the Department of Market Surveillance.

Rules concerning the manners of bids and offers, priority, solicitation and crossing must also be complied with as appropriate.

The file numbers of the rule changes are SR-CBOE-94-27 and SR-CBOE-94-38. Copies of the filings may be obtained from the Exchange's Legal Department. Questions regarding this circular may be directed to Jeffrey B. Schroer, Vice President, at (312) 786-7716 or Pat Sizemore, Director at (312) 786-7752 in the Department of Market Surveillance.