

BEFORE THE BUSINESS CONDUCT COMMITTEE
OF THE
CHICAGO BOARD OPTIONS EXCHANGE INCORPORATED

)	
In the Matter of:)	
)	
PaineWebber, Inc.)	
1200 Harbor Blvd.)	
Building A, Legal Department)	File No. 96-0047
Weehawken, New Jersey 07087)	
)	
Respondent)	
)	

DECISION ACCEPTING OFFER OF SETTLEMENT

This proceeding was instituted by the Business Conduct Committee (the "Committee") of the Chicago Board Options Exchange, Incorporated (the "Exchange") as a result of an investigation by the staff of the Exchange, which indicated that there was probable cause for finding a violation within the disciplinary jurisdiction of the Exchange. In accordance with that determination, the Committee directed the issuance of a Statement of Charges ("Statement of Charges"). Pursuant to Exchange Rule 17.8, the respondent ("Respondent"), PaineWebber, Inc. ("PaineWebber") submitted an offer of settlement ("Offer of Settlement").

In submitting the Offer of Settlement, the Respondent neither admitted nor denied the violations alleged in the Statement of Charges.

The Respondent has agreed that the determination of the Committee to accept the Offer of Settlement shall constitute a final Decision, and, as provided in Exchange Rule 17.8, the Respondent may not seek review thereof.

The Respondent understands and acknowledges that the Committee's decision in this matter will become part of its disciplinary record and may be considered in any future Exchange proceeding.

With due regard to the particulars of this matter, the Committee believes it is appropriate to accept the Respondent's Offer of Settlement based on the following stipulated facts and findings and thereby to impose the sanction specified below.

FACTS

1. During all relevant periods herein, the Respondent, PaineWebber, was a member of the Exchange.

2. During all relevant periods herein, PaineWebber was registered with the Exchange to transact business on the Exchange in accordance with Exchange Rules as a clearing member, as a member organization associated with a floor broker, and as a member organization authorized to conduct a non-member customer business.
3. During all relevant periods herein, another Exchange Member Organization ("Member Organization"), was registered with the Exchange to transact business on the Exchange in accordance with Exchange Rules as a member organization approved to conduct a non-member customer business.
4. During all relevant periods herein, and pursuant to a written agreement between PaineWebber and Member Organization dated December 5, 1978, as amended, PaineWebber agreed to act as clearing agent for Member Organization on a "fully disclosed basis".
5. During all relevant periods herein, a person associated with Member Organization ("Associated Person"), was registered with the Exchange to transact business on the Exchange in accordance with Exchange Rules as an associated person of Member Organization working as a trader's assistant on Member Organization's proprietary trading desk. During all relevant periods herein, Associated Person maintained a personal trading account at Member Organization.
6. During all relevant periods herein, Exchange Rules 4.1 - Just and Equitable Principles of Trade; 4.2 - Adherence to Law; 6.8(a)(i) - RAES Operations in Equity Options; 6.24(a) - Orders Required to Be in Written Form; 6.51(d) and Interpretation and Policy .02 thereunder - Reporting Duties; 7.4(a) - Obligations for Orders; 9.8 - Supervision of Accounts; 12.1 - Margin, General Rule; 12.9 - Meeting Margin Calls by Liquidation Prohibited; File No. SR-CBOE-85-32, Order Approving Rule Changes by the CBOE Relating to the Retail Automatic Execution System, Securities Exchange Act Release No. 34-23490 dated August 1, 1986 ("SR-CBOE-85-32"); Regulation T Section 220.8 of the Board of Governors of the Federal Reserve Board ("FRB") - Credit by Brokers and Dealers (Cash Account); and New York Stock Exchange Rule 431(f)9, were in full force and effect.
7. During all relevant periods herein, only non broker-dealer customer orders were entitled to be entered on and executed through the Exchange's Retail Automatic Execution System ("RAES") and Public Customer Limit Order Book ("Book").
8. During the period from in or about January 1992 through in or about June 1996, PaineWebber, through its wholly owned subsidiary, Correspondent Services Corporation ("CSC"), accepted numerous orders for the accounts of certain of its correspondent broker-dealers and allowed, primarily because of a computer system flaw, these broker-dealer orders to be entered and executed on the Exchange through RAES or the Book.
9. During the period from in or about January 1992 through in or about June 1996, PaineWebber, through CSC, failed to designate, primarily because of a computer system flaw, numerous broker-dealer orders including the orders referred to in Paragraph 8 above, with the required broker-dealer "b" designation.
10. During the period from in or about January 1992 through in or about June 1996, PaineWebber, through CSC, filed incorrect account origin code information with the

Exchange for the orders referred to in Paragraph 9 above, by allowing these orders to be entered with a "c" designation, indicating that the orders were customer orders, when these orders were for the accounts of broker-dealers and should have been entered with the required broker-dealer "b" designation.

11. During the period from in or about January 1992 through in or about June 1996, PaineWebber, through CSC, failed to establish and implement reasonable procedures to review and monitor the entry and execution of broker-dealer orders, and as a result, PaineWebber, through CSC, failed to prevent the conduct described in each of Paragraphs 8 through 10 above from occurring. Since that time, PaineWebber has taken steps to correct the computer system flaw at issue so that broker-dealer orders entered by correspondent firms will be properly designated "b" orders and processed in a manner which should enable PaineWebber to better monitor the issues raised herein. PaineWebber also issued additional instructions to all its correspondent firms concerning the proper procedures for entering broker-dealer orders.
12. During the period from in or about December 1991 through in or about May 1995, PaineWebber, through CSC, failed on numerous occasions to either impose or enforce 90 day restrictions¹ in the cash account carried by CSC for the personal trading account of Associated Person, thereby allowing Associated Person to engage in a practice of "free riding"² in his personal trading account. Since that time, PaineWebber has developed and implemented new procedures, including a revamped computer system, which will enable the firm to better monitor those instances in which 90 day restrictions may be necessary.

FINDINGS

13. The acts, practices and conduct described in Paragraph 8 above constitute violations of Exchange Rules 4.1, 6.8(a)(i), 7.4(a) and SR-CBOE-85-32 by PaineWebber in that PaineWebber caused numerous orders on behalf of various broker-dealers to be entered and executed either through RAES or the Book, when such orders were ineligible for entry and execution through RAES and the Book.
14. The acts, practices and conduct described in Paragraph 9 above constitute violations of Exchange Rule 6.24(a) by PaineWebber in that PaineWebber caused the numerous orders described in Paragraph 9 above to be designated as orders on behalf of customer accounts, when those orders were on behalf of broker-dealer accounts.
15. The acts, practices and conduct described in Paragraph 10 above constitute violations of Exchange Rule 6.51(d) and Interpretation and Policy .02 thereunder by PaineWebber in that PaineWebber failed to report to the Exchange correct account origin information for numerous orders.

¹ §220.8 of Regulation T requires that in the event a security is purchased in a cash account and is sold prior to the receipt of full cash payment for that purchase, a 90 day restriction on the account must be imposed on the date the security is sold. For a period of 90 days from the effective date of the restriction, the account must have full cash payment on deposit prior to making any new purchases.

² "Free riding" involves the purchase and sale of a security in a cash account without making full cash payment for the security within 7 business days of the date of purchase.

16. The acts, practices and conduct described in the first sentence of Paragraph 11 above constitute violations of Exchange Rules 4.2 and 9.8 by PaineWebber, in that PaineWebber failed to establish and implement reasonable supervisory procedures concerning the entry and execution of broker-dealer orders, and failed to prevent the conduct described in Paragraphs 8 through 10 above from occurring.
17. The acts, practices and conduct described in the first sentence of Paragraph 12 above constitute violations of Exchange Rules 4.2, 9.8, 12.1 and 12.9, FRB Regulation T Section 220.8, and New York Stock Exchange Rule 431(f)9 by PaineWebber, in that PaineWebber failed to prevent Associated Person from engaging in a practice of "free riding" in his personal trading account.

SANCTION

The sanction to be imposed shall consist of:

- 1) a fifty thousand dollar (\$50,000) fine;
- 2) a censure; and,
- 3) Respondent agrees to the following undertakings:
 - a) within 60 days of the issuance of the Decision Accepting the Offer of Settlement in this matter ("Decision"), submit to the Exchange's Department of Compliance acceptable written procedures concerning i) the entry and execution of proprietary account orders of PaineWebber's broker-dealer correspondents, and ii) the submission of trade information to the Exchange covering the orders described in i) above; and
 - b) within 6 months following the issuance of the Decision, PaineWebber shall retain a qualified outside consultant (i.e., other than PaineWebber personnel) to conduct a review of: (i) the procedures described in Paragraph 3a above, including the effectiveness of the relevant computer system procedures; and (ii) PaineWebber's procedures for correspondent accounts concerning the detection of free riding, and the imposition and enforcement of 90 day restrictions (the "Review"). The findings of the Review shall be submitted to the Compliance Committee of PaineWebber's Board of Directors ("Committee") within 30 days of the completion of the Review, and submission thereof shall be confirmed to the Exchange's Department of Compliance. Further, if the Review recommends any revisions or additions to PaineWebber's procedures, PaineWebber shall furnish such recommendations to the Exchange's Department of Compliance.

ORDER

ACCORDINGLY IT IS ORDERED THAT, the Respondent, PaineWebber, shall be and hereby is censured and fined in the amount of fifty thousand dollars (\$50,000). The Respondent is also hereby ordered to:

- a) within 60 days of the issuance of the Decision Accepting the Offer of Settlement in this matter ("Decision"), submit to the Exchange's Department of Compliance acceptable written procedures concerning i) the entry and execution of proprietary account orders of PaineWebber's broker-dealer correspondents, and ii) the submission of trade information to the Exchange covering the orders described in i) above; and
- b) within 6 months following the issuance of the Decision, PaineWebber shall retain a qualified outside consultant (i.e., other than PaineWebber personnel) to conduct a review of: (i) the procedures described in Paragraph 3a above, including the effectiveness of the relevant computer system procedures; and (ii) PaineWebber's procedures for correspondent accounts concerning the detection of free riding, and the imposition and enforcement of 90 day restrictions (the "Review"). The findings of the Review shall be submitted to the Compliance Committee of PaineWebber's Board of Directors ("Committee") within 30 days of the completion of the Review, and submission thereof shall be confirmed to the Exchange's Department of Compliance. Further, if the Review recommends any revisions or additions to PaineWebber's procedures, PaineWebber shall furnish such recommendations to the Exchange's Department of Compliance.

SO ORDERED
FOR THE COMMITTEE

/s/ Bruce I. Andrews
Bruce I. Andrews
Chairman
Business Conduct Committee

May 12, 1997
Date