

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52830; File No. SR-OCC-2005-15]

### Self-Regulatory Organizations; the Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Rejection of Erroneous Post-Trade Instructions

November 23, 2005.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> notice is hereby given that on October 26, 2005, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II and III below, which Items have been prepared primarily by OCC. OCC filed the proposed rule change pursuant to section 19(b)(3)(A)(ii) of the Act<sup>2</sup> and Rule 19b-4(f)(2) thereunder<sup>3</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The proposed rule change will authorize OCC to reject all types of post-trade transactions when OCC determines, in its sole discretion, that the input regarding the adjustment or other transaction contains an error or omission.

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

In its filing with the Commission, OCC 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 self-regulatory organization has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.<sup>4</sup>

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

Under the proposed rule change, OCC will amend Article VI, Section 1, of its By-Laws by adding paragraph (c) to Interpretations and Policies .01 and will amend Rule 403(b) to expressly authorize OCC to reject all types of post-trade transactions that OCC determines, in its sole discretion, that the input regarding the adjustment or other transaction contains an error or omission.

OCC occasionally receives instructions from clearing members attempting to effect post-trade transactions, such as clearing member trade assignment ("CMTA")<sup>5</sup> transfers and position adjustments, that appear to be erroneous and that if not corrected would create large settlement obligations that could pose substantial credit risk for OCC. For example, recently an OCC clearing member submitted a CMTA transfer instruction specifying a premium value of \$6,500 instead of \$1.65 that would have produced a \$5 billion settlement requirement. Such mistakes are ordinarily corrected by communicating with the clearing member or clearing members involved. However, OCC may not always be able to contact the affected parties or to obtain a timely agreement as to the appropriate corrective measure.

Currently, OCC's By-Laws and Rules do not expressly authorize OCC to reject post-trade transactions when OCC determines that the input regarding such transactions contains an error or omission.<sup>6</sup> Unlike option exchange transactions, for which it is OCC's general policy not to reject, post-trade transactions have not been examined for errors through the trade matching process and, therefore, are more vulnerable to errors and omissions.

OCC believes that the proposed changes are consistent with the purposes and requirements of section 17A of the Act<sup>7</sup> because such changes are designed to enable OCC to safeguard securities and funds in its possession or control for which it is responsible.

<sup>5</sup> For an explanation of CMTA, refer to Securities Exchange Act Release No. 51350 (Mar. 9, 2005), 70 FR 12934 (Mar. 16, 2005).

<sup>6</sup> In contrast, OCC Rules 614(c) and (e) authorize OCC to reject erroneous instructions for pledge positions and to release pledged positions, and OCC Rule 2202 enables OCC to reject erroneous stock loan transactions.

<sup>7</sup> 15 U.S.C. 78q-1.

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

OCC believes that the proposed rule change will not impact or impose any burden on competition.

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

OCC has not solicited or received written comments relating to the proposed rule change. OCC will notify the Commission of any written comments it receives.

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

The foregoing rule change has become effective pursuant to section 19(b)(3)(A)(i) of the Act<sup>8</sup> and Rule 19b-4(f)(1)<sup>9</sup> thereunder because it constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within sixty days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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-OCC-2005-15 on the subject line.

##### Paper Comments

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

All submissions should refer to File Number SR-OCC-2005-15. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>9</sup> 17 CFR 240.19b-4(f)(1).

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

<sup>2</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>3</sup> 17 CFR 240.19b-4(f)(2).

<sup>4</sup> The Commission has modified the text of the summaries prepared by OCC.

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, 100 F Street, NE., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at OCC's principal office and on OCC's Web site at [http://www.optionsclearing.com/publications/rules/proposed\\_changes/proposed\\_changes.jsp](http://www.optionsclearing.com/publications/rules/proposed_changes/proposed_changes.jsp). 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-OCC-2005-15 and should be submitted on or before December 22, 2005.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52827; File No. SR-PCX-2005-56]

### Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Relating to the Directed Order Process and the Establishment of Designated Market Makers and Lead Market Makers

November 23, 2005.

#### I. Introduction

On April 21, 2005, the Pacific Exchange, Inc. ("PCX" or "Exchange"), through its wholly-owned subsidiary PCX Equities, Inc. ("PCXE"), filed with

the Securities and Exchange Commission ("Commission" or "SEC"), 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> a proposed rule change to modify its rules governing the Directed Order Process on the Archipelago Exchange ("ArcaEx").<sup>3</sup> The PCX filed Amendment No. 1 to the proposed rule change on October 4, 2005.<sup>4</sup> The proposed rule change, as amended, was published for comment in the **Federal Register** on October 13, 2005.<sup>5</sup> The Commission received no comments from the public in response to the proposed rule change. The PCX filed Amendment No. 2 to the proposed rule change on November 17, 2005.<sup>6</sup> This order approves the proposed rule, as amended by Amendment No. 1; grants accelerated approval to Amendment No. 2; and solicits comments from interested persons on Amendment No. 2.

#### II. Description

The PCX proposed to add two new classifications of Market Makers, Designated Market Makers ("DMMs") and Lead Market Makers ("LMMs"), in connection with ArcaEx's Directed Order Process. Under the proposal, only DMMs and LMMs would be eligible to receive orders in ArcaEx's Directed Order Process. DMMs would be required to meet certain selection criteria and ongoing performance criteria, making them eligible to participate in the Directed Order Process. LMMs would be granted exclusive eligibility to receive Directed Orders and would be held to higher ongoing performance standards than DMMs in listings for which ArcaEx is the primary market. Such ongoing performance standards would include (i) percent of time the DMM is quoting at the NBBO; (ii) percent of executions better than the NBBO; (iii) average displayed size; (iv) average quoted spread; and (v) in the event the security is a derivative security, the ability of the DMM to transact in the underlying markets. LMMs would be held to higher ongoing performance standards than DMMs. Although the Exchange would have the ability to apply specific levels to be used in defining the performance standards, the Exchange would not modify the types of standards to be used

without changing its rules. The Exchange also proposed to amend PCXE Rule 7.22 to provide the Corporation with the ability to limit the number of DMMs with prior written notice to ETP Holders. Lastly, PCXE Rule 7.25 would be modified to require LMMs to register as Odd Lot Dealers in the securities in which they are registered as LMM.

The PCX also sought to modify its Directed Order process in a number of ways. First, the Exchange proposed to add a provision that requires Users<sup>7</sup> to be given permission by DMMs in order to send a Directed Order to that DMM. The Exchange also proposed to eliminate the provision limiting the Directed Order Process to the Core Trading Session and proposed to eliminate a provision that suspends the Directed Order Process when a locked or crossed market exists in a security. In addition, the amendment to the definition would also make clear that a Directed Fill specifies the size and price of the Directed Fill.

The Exchange also proposed that marketable Directed Orders would first attempt to match against the DMM to which the order has been directed, but that, prior to execution, Directed Orders matched against DMMs pursuant to their Directed Fill instructions first would be executed against any displayed order in the Arca Book priced at or better than the terms of the Directed Fill before executing as a directed match.<sup>8</sup> If such matched orders are broken up by orders on the Arca Book, the remaining portion of the Directed Order would be posted in the Arca Book. Lastly, the Exchange proposed to delete a reference in the Directed Order Process rules restricting the price at which executions can occur within the Directed Order Process.

In Amendment No. 2, the Exchange proposed to remove provisions in PCXE Rule 7.34(d) that limit the availability of the Directed Order Process during the Opening Session and Late Trading Session.

#### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether Amendment No. 2 is consistent with the Act. Comments may be submitted by any of the following methods:

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See PCXE Rules 7.31 and 7.37.

<sup>4</sup> Amendment No. 1 replaced and superseded the original filing in its entirety.

<sup>5</sup> See Securities Exchange Act Release No. 52566 (October 5, 2005), 70 FR 59791.

<sup>6</sup> Amendment No. 1 clarified language in PCXE Rule 7.34(d).

<sup>7</sup> See PCXE Rule 1.1(yy).

<sup>8</sup> Accordingly, a Directed Order would only execute against a Directed Fill at a price superior to the Arca best bid or offer.

<sup>10</sup> 17 CFR 200.30-3(a)(12).