



Memorandum #1922-08

## MEMORANDUM

To: All Options Member and Member Organizations  
Subject: Representing Spread Orders  
Date: November 13, 2008

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The Exchange staff wants to remind its Members how they should represent spread orders in the options trading crowd. Pursuant to Rule 1066, a spread order is an order to buy a stated number of option contracts and to sell a stated number of option contracts in a different series of the same option and may be bid for or offered on a total net debit or credit basis. The following examples intend to clarify recently raised questions:

- 1) If a Floor Broker announces to the Crowd, "I want to buy 500 Apple Nov 100 Calls and sell 600 Apple Oct 100 calls for even money," the Exchange considers this is a spread, because "even money" constitutes a total net debit/credit of zero. Another way to represent this order is to specifically state "zero," however, this is not necessary in order for the order to be considered a spread.
- 2) If a Floor Broker says, "I want to buy 1000 IWM Nov 45 Calls and sell 1000 Dec 45 calls for \$240,000 credit," the Exchange considers this a spread, because "\$240,000 credit" constitutes a net debit/credit price. Another way to represent this order is to state it is for a "2.40 credit." In this regard, the spread order may be represented in either net dollars or dollars per contract terms.
- 3) If a Floor Broker says, "I will buy 500 SPY Nov 105 calls and sell the Nov 110 calls on a ratio where I can spend \$36,000 Net," the Exchange does not consider this a spread because it does not reflect a "stated" number of contracts to be sold, which Rule 1066 requires. One purpose of the requirement that the number of contracts bought and sold be stated is to make clear what the orders represent, and permit the trading crowd the opportunity to provide responsive markets.
- 4) If a Floor Broker says, "I will buy 1,000 IBB Jan 65 puts and sell 2,000 Mar 70 puts for \$1.179700M," the Exchange does not consider the cash value in this example permissible because it is not convertible into a permissible minimum price increment.

Please be reminded that Rule 1064 governs crossing, facilitation and solicited orders, including spread orders. Specifically, throughout Rule 1064, trading crowd participants must be given a reasonable opportunity to respond to the order. The text of this rule appears below as a reminder.

### **Rule 1064. Crossing, Facilitation and Solicited Orders**

(a) An Options Floor Broker who holds orders to buy and sell the same option series may cross such orders, provided that he proceeds in the following manner:

- (i) In accordance with his responsibilities for due diligence, pursuant to Rule 155, an Options Floor Broker shall request bids and offers for such options series and make all persons in the trading crowd aware of his request.
- (ii) After providing an opportunity for such bids and offers to be made, he must bid and offer at prices differing by the minimum increment and must improve the market by bidding above the highest bid or offering below the lowest offer.
- (iii) If such higher bid or lower offer is not taken, he may cross the orders at such higher bid or lower offer by announcing by public outcry that he is crossing and giving the quantity and price.

(b) *Facilitation Orders.* A Floor Broker holding an options order for a public customer and a contraside order may cross such orders in accordance with paragraph (a) above or may execute such orders as a facilitation cross in the following manner:

- (i) The Floor Broker or his employees must enter the appropriate notation onto the Options Floor Broker Management System for the public customer's order, together with all of the terms of the order, including any contingency involving other options or the underlying or related securities.
- (ii) The Floor Broker shall request markets for the execution of all options components of the order. After providing an opportunity for such markets to be made, the Floor Broker shall announce that he holds an order subject to facilitation and shall bid (or offer) in between the market for each options component and disclose all terms and conditions of the order including all securities which are components of the order.
- (iii) After all market participants in the crowd are given a reasonable opportunity to accept all terms and conditions made on behalf of the public customer whose order is subject to facilitation, the Floor Broker may immediately thereafter cross all or any remaining part of such order and the facilitation order at each customer's bid or offer by announcing by public outcry that he is crossing and by stating the quantity and price(s).

Once a Floor Broker has announced an order as subject to facilitation and has established a bid (or offer) in between the market for the option(s) to be facilitated, the order cannot be broken up by a subsequent superior bid or offer for just one component to the facilitated order.

(c) *Solicited Orders.* For the purpose of this Rule, a solicitation occurs whenever an order, other than a cross, is presented for execution in the trading crowd resulting from an away-from-the-crowd expression of interests to trade by one broker dealer to another.

- (i) If a member appears in the trading crowd in response to a solicitation, other trading crowd participants must be given a reasonable opportunity to respond to the order which prompted the solicitation before the solicited member may respond to the order. Prior to a bid (or offer) being made on behalf of any such order the solicitor or his representative must identify the solicited party to the trading crowd and give all information to the trading crowd which was given to the solicited member.
- (ii) A member or member organization representing an order in options ("originating order") may solicit another member, member organization or non-member broker-dealer outside the trading crowd ("solicited party") to participate in the transaction on a proprietary basis provided that the member or member organization representing the originating order, upon entering the trading crowd to execute the transaction, must:

(A) announce to the trading crowd the same terms of the originating order that have been disclosed to the solicited party;

(B) bid at the price he/she is prepared to buy from the solicited party or offer at the solicited price he/she is prepared to sell to the solicited party; and

(C) give the trading crowd a reasonable opportunity to accept the bid or offer.

(iii) The Floor Broker or his employees must note on the Options Floor Broker Management System that the trade involves a solicited order.

(d) No member organization or person associated with a member or member organization who has knowledge of the material terms and conditions of a solicited order, an order being facilitated, or orders being crossed, the execution of which are imminent, shall enter, based on such knowledge, an order to buy or sell an option for the same underlying security; an order to buy or sell the security underlying such class; or an order to buy or sell any related instrument until (i) the terms and conditions of the order and any changes in the terms of the order of which the member, member organization or person associated with a member or member organization has knowledge are disclosed to the trading crowd, or (ii) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received. For purposes of this Rule, an order to buy or sell a "related instrument" means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

• • • **Commentary:** -----

**.01** A violation of this Rule may be considered conduct inconsistent with just and equitable principles of trade.

**.02 Firm Participation Guarantees.** (i) Notwithstanding the provisions of paragraphs (a) and (b) of this Rule, when a Floor Broker holds an equity, index or U.S. dollar-settled foreign currency option order of the eligible order size or greater ("original order"), the Floor Broker is entitled to cross a certain percentage of the original order with other orders that he is holding or in the case of a public customer order, with a facilitation order of the originating firm (i.e., the firm from which the original customer order originated).

(ii) The Options Committee may determine, on an option by option basis, the eligible size for an order that may be transacted pursuant to this Commentary, however, the eligible order size may not be less than 500 contracts. Orders for less than 500 contracts may be crossed pursuant to this rule but are not subject to subsection (iii) below pertaining to participation guarantees. In accordance with his responsibilities for due diligence, a Floor Broker representing an order of the eligible order size or greater which he wishes to cross shall request bids and offers for such option series and make all persons in the trading crowd aware of his request. In determining whether an order satisfies the eligible order size requirement, any multi-part or spread order must contain one leg alone which is for the eligible order size or greater. If the same member organization is the originating firm and also the specialist for the particular class of options to which the order relates, then the specialist is not entitled to any Enhanced Specialist Participation with respect to the particular cross transaction.

(iii) The percentage of the order which a Floor Broker is entitled to cross in equity, index and U.S. dollar settled foreign currency options, after all public customer orders that were (1) on the limit order book and then (2) represented in the trading crowd at the time the market was

established have been satisfied, is 40% of the remaining contracts in the order if the order is traded at or between the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market.

- (iv) When crossing an order pursuant to this Commentary, a Floor Broker must disclose on its order ticket for any order which is subject to crossing, all of the terms of such order, including any contingency involving, and all related transactions in, either options or, in the case of equity or index options, underlying or related securities. The Floor Broker, in the case of equity or index options, must disclose all securities that are components of the customer order which is subject to crossing before requesting bids and offers for the execution of all components of the order.
  - (v) Once the trading crowd has provided a quote, it will remain in effect until: (A) a reasonable amount of time has passed, or (B) there is a significant change in the price of the underlying security, or (C) the market given in response to the request has been improved. In the case of a dispute, the term "significant change" will be interpreted on a case-by-case basis by an Options Exchange Official based upon the extent of the recent trading in the option and, in the case of equity and index options, in the underlying security, and any other relevant factors.
  - (vi) If a trade pursuant to this Commentary occurs when the specialist is on parity with one or more controlled accounts, then the Enhanced Specialist Participation which is established pursuant to Exchange Rule 1014(g)(ii)-(iv) shall apply only to the number of contracts remaining after the following orders have been satisfied: those public customer orders which trade ahead of the cross transaction, and any portion of an order being crossed against the original order being represented by the Floor Broker.
    - (A) The specialist shall not be entitled to receive the Enhanced Specialist Participation in equity, index and U.S dollar settled foreign currency options after customer orders have been executed for orders crossed pursuant to this paragraph (vi) unless the Floor Broker has chosen to cross less than its 40% entitlement, in which case the Enhanced Specialist Participation will be a percentage that combined with the percentage the firm crossed is no more than 40% of the original order.
- If the trade occurs at a price other than the specialist's disseminated bid or offer, the specialist is entitled to no guaranteed participation.
- (vii) The members of the trading crowd who established the market will have priority over all other orders that were not represented in the trading crowd at the time that the market was established (but not over customer orders on the book) and will maintain priority over such orders except for orders that improve upon the market. A Floor Broker who is holding a customer order and either a facilitation or solicited order and who makes a request for a market will be deemed to be representing both the customer order and either the facilitation order or solicited order, so that the customer order and the facilitation order or solicited order will also have priority over all other orders that were not being represented in the trading crowd at the time the market was established.
  - (viii) Nothing in this paragraph is intended to prohibit a Floor Broker or a specialist from trading more than their percentage entitlements if the other members of the trading crowd do not choose to trade the remaining portion of the order.
  - (ix) A Floor Broker may not cross an order that he is holding with an order from a Registered Options Trader that is then in the trading crowd.

(x) Spread, straddle, combination or hedge orders, as defined in Exchange Rule 1066, on opposite sides of the market may be crossed, provided that the Floor Broker holding such orders proceeds in the manner described in paragraphs (a) or (b) of this Rule as appropriate. Members may not prevent a spread, straddle, stock-option, or combination cross from being completed by giving a competing bid or offer for one component of such order. In determining whether an order satisfies the eligible order size requirement, any multi-part or spread order must contain one leg which, standing alone, is for the eligible order size or greater.

**.03** A Floor Broker crossing a public customer order with an order that is not a public customer order, when providing for a reasonable opportunity for the trading crowd to participate in the transaction, shall disclose the public customer order that is subject to crossing prior to the execution of the order.