

## **Regulatory Information Circular – 2000-14**

**To:** ISE Market Makers

**Date:** December 26, 2000

**Re: Change to Rule 810 (“Chinese Walls”)**

On December 15, 2000, the SEC approved Rule Change File No. SR-ISE-00-09, which amends Rule 810, Limitations on Dealings. (Securities Exchange Act Release No. 34-43729 (December 15, 2000), 65 FR 81551)

ISE Rule 810 requires that ISE market makers maintain a "Chinese Wall" between their market making activity and certain other business activities, including their trading as an Electronic Access Member (“EAM”). The purpose of the rule change is to ease Rule 810 to allow members to conduct proprietary trading as an EAM in the same physical space as their market making activities, but only (i) in options that are not within their market making assignments or (ii) in options which, pursuant to regulatory requirements, the member is prohibited from making markets.<sup>1</sup>

The amendment permits only proprietary trading without the Chinese Wall, and does not permit the market maker to enter agency orders (except with respect to proprietary orders for its affiliates) without complying with the full restrictions of Rule 810.

The full text of amended Rule 810 is attached. All of the ISE’s rules, proposed rule changes and Regulatory Information Circulars can be found on the ISE’s web site ([www.iseoptions.com](http://www.iseoptions.com)).

Any questions regarding this rule change may be directed to Katherine Simmons, Associate General Counsel at 212-897-0233 or [ksimmons@iseoptions.com](mailto:ksimmons@iseoptions.com).

---

<sup>1</sup> This latter provision is intended to apply to market makers that are specialists in the underlying stock on the New York Stock Exchange, whose rules limit the options trading of specialists and affiliated firms to "hedging activities," thus prohibiting them from making markets in such options. See NYSE Rule 105.

Text of the Amended Rule (underlining indicates additions)

**Rule 810. Limitations on Dealings**

(a) *General Rule.* A market maker on the Exchange may engage in Other Business Activities, or it may be affiliated with a broker-dealer that engages in Other Business Activities, only if there is a Chinese Wall between the market making activities and the Other Business Activities. “Other Business Activities” mean:

(1) conducting an investment or banking or public securities business;

(2) making markets in the stocks underlying the options in which it makes markets; or

(3) functioning as an Electronic Access Member.

(b) *Chinese Wall.* For the purposes of this rule, a Chinese Wall is an organizational structure in which:

(1) The market making functions are conducted in a physical location separate from the locations in which the Other Business Activities are conducted, in a manner that effectively impedes the free flow of communications between DTRs and persons conducting the Other Business Activities. However, upon request and not on his own initiative, a DTR performing the function of a market maker may furnish to a person performing the function of an Electronic Access Member or other persons at the same firm or an affiliated firm (“affiliated persons”), the same sort of market information that the DTR would make available in the normal course of its market making activity to any other person. The DTR must provide such information to affiliated persons in the same manner that he would make such information available to a non-affiliated person.

(2) There are procedures implemented to prevent the use of material non-public corporate or market information in the possession of persons on one side of the wall from influencing the conduct of persons on the other side of the wall. These procedures, at a minimum, must provide that:

(i) the DTR performing the function of a market maker does not take advantage of knowledge of pending transactions, order flow information, corporate information or recommendations arising from the Other Business Activities; and

(ii) all information pertaining to the market maker’s positions and trading activities is kept confidential and not made available to persons on the other side of the Chinese Wall.

(3) Persons on one side of the wall may not exercise influence or control over persons on the other side of the wall, provided that:

(i) the market making function and the Other Business Activities may be under common management as long as any general management oversight does not conflict with or compromise the market maker's responsibilities under the Rules of the Exchange; and

(ii) the same person or persons (the "Supervisor") may be responsible for the supervision of the market making and Electronic Access Member functions of the same firm or affiliated firms in order to monitor the overall risk exposure of the firm or affiliated firms. While the Supervisor may establish general trading parameters with respect to both market making and other proprietary trading other than on an order-specific basis, the Supervisor may not:

(A) actually perform the function either of market maker or Electronic Access Member;

(B) provide to any person performing the function of an Electronic Access Member any information relating to market making activity beyond the information that a DTR performing the function of a Primary Market Maker may provide under subparagraph (b)(1), above; nor

(C) provide a DTR performing the function of market maker with specific information regarding the firm's pending transactions or order flow arising out of its Electronic Access Member activities.

(c) *Documenting and Reporting of Chinese Wall Procedures.* A Member implementing a Chinese Wall pursuant to this Rule shall submit to the Exchange a written statement setting forth:

(1) The manner in which it intends to satisfy the conditions in paragraph (b) of this Rule, and the compliance and audit procedures it proposes to implement to ensure that the Chinese Wall is maintained;

(2) The names and titles of the person or persons responsible for maintenance and surveillance of the procedures;

(3) A commitment to provide the Exchange with such information and reports as the Exchange may request relating to its transactions;

(4) A commitment to take appropriate remedial action against any person violating this Rule or the Member's internal compliance

and audit procedures adopted pursuant to subparagraph (c)(1) of this Rule, and that it recognizes that the Exchange may take appropriate remedial action, including (without limitation) reallocation of securities in which it serves as a market maker, in the event of such a violation;

(5) Whether the Member or an affiliate intends to clear its proprietary trades and, if so, the procedures established to ensure that information with respect to such clearing activities will not be used to compromise the Member's Chinese Wall, which procedures, at a minimum, must be the same as those used by the Member or the affiliate to clear for unaffiliated third parties; and

(6) That it recognizes that any trading by a person while in possession of material, non-public information received as a result of the breach of the internal controls required under this Rule may be a violation of Rules 10b-5 and 14e-3 under the Exchange Act or one or more other provisions of the Exchange Act, the rules thereunder or the Rules of the Exchange, and that the Exchange intends to review carefully any such trading of which it becomes aware to determine whether a violation has occurred.

(d) *Exchange Approval of Chinese Wall Procedures.* The written statement required by paragraph (c) of this Rule must detail the internal controls that the Member will implement to satisfy each of the conditions stated in that Rule, and the compliance and audit procedures proposed to implement and ensure that the controls are maintained. If the Exchange determines that the organizational structure and the compliance and audit procedures proposed by the Member are acceptable under this Rule, the Exchange shall so inform the Member, in writing. Absent the Exchange finding a Member's Chinese Wall procedures acceptable, a market maker may not conduct Other Business Activities.

(e) *Clearing Arrangements.* Subparagraph (c)(5) permits a Member or an affiliate of the Member to clear the Member's market maker transactions if it establishes procedures to ensure that information with respect to such clearing activities will not be used to compromise the Chinese Wall. In this regard:

(1) The procedures must provide that any information pertaining to market maker securities positions and trading activities, and information derived from any clearing and margin financing arrangements, may be made available only to those employees (other than employees actually performing clearing and margin functions) specifically authorized under this Rule to have access to such information or to other employees in senior management positions who are involved in exercising general managerial oversight with respect to the market making activity.

(2) Any margin financing arrangements must be sufficiently flexible so as not to limit the ability of any market maker to meet market making or other obligations under the Exchange's Rules.

(f) *Exception to Chinese Wall Requirement.* A market maker shall be exempt from paragraph (a)(3) of this Rule to the extent the market maker complies with the following conditions:

(1) such member functions as an Electronic Access Member solely in options classes (i) contained in Groups to which the member is not appointed as a market maker pursuant to Rule 802 or (ii) in which the member is prohibited from acting as a market maker pursuant to regulatory requirements; and

(2) the member enters orders as an Electronic Access Member only for (i) the proprietary account of the member or (ii) the account of entities that are affiliated with the member.

[Adopted February 24, 2000; amended December 15, 2000 (SR-ISE-00-09).]