

MEMORANDUM

TO: Members, Member Organizations, Participants, Participant Organizations

FROM: Richard S. Rudolph, Vice President and Counsel
Legal Department

DATE: February 5, 2007

RE: SEC Approves Proposal to Establish a Maximum Number of Quoting
Participants Permitted to be Assigned in Each Option

As one element of a larger plan to conserve quote capacity by encouraging efficient quoting (in light of the imminent implementation of penny quoting and trading in options), and in order to address the costs required to process excess quoting, the Securities and Exchange Commission (“SEC” or “Commission”) has **approved** an Exchange proposal to amend Exchange Rule 507, which governs the assignment of options to Streaming Quote Traders (“SQTs”) and Remote Streaming Quote Traders (“RSQTs”), by adding commentary to the Rule establishing a maximum number of quoting participants that may be assigned to a particular equity option at any one time.

New Rule 507 establishes: (i) a maximum number of quoters (“MNQ”) in equity options based on each option’s monthly trading volume; (ii) a process for recalculating the MNQ based upon changes in an option’s monthly trading volume; (iii) an increase to the MNQ due to exceptional circumstances; (iv) the process by which the Exchange will notify market participants of changes to the MNQ; and (v) additional criteria relating to the process by which the Exchange will assign SQT and/or RSQT applicants in options in the event that there are more applicants for assignment in a particular option than there are positions.

Commentary .02 to Rule 507 sets forth tiered MNQ levels providing for 20 participants for the top 5% most actively traded options; 15 participants for next 10% most actively traded options, and 10 market participants for all other options. The ranking is based upon the preceding month’s national volumes.

The MNQ will be recalculated within the first five days of each month based on the previous month’s trading volume (“new MNQ”). The Exchange will immediately implement the new MNQ if the number of assigned participants in the option on the last day of the month equals or is less than the new MNQ. Under circumstances in which the number of assigned participants is greater than the new MNQ, the option will have an “increased” MNQ equal to the number of assigned participants quoting electronically in

that option on the last day of the month. The “increased” MNQ will automatically decrease if an assigned participant changes or ceases the assignment in the option. The “increased” MNQ will continue to decrease until the number of assigned participants equal the new MNQ, at which point the number of assigned participants in the option may not exceed the new MNQ. The Exchange will inform market participants of changes to the MNQ via Exchange circular.

New Rule 507 adds additional criteria for the Options Allocation, Evaluation and Securities Committee (“OAESC”) to consider when determining whether to assign an option to a member in the situation where there are more applicants for assignment in a particular option than there are positions available. In this situation, the OAESC will consider (i) the financial and technical resources available to the applicant; (ii) the applicant’s experience and expertise in market making or options trading; and the applicant’s prior performance as a specialist, SQT or RSQT, based on evaluations conducted pursuant to Exchange Rule 510, which includes quantified measures of performance.

Members that are assigned in a particular option as of the date of Commission approval of this proposed rule change will be guaranteed a position as a quoting participant in the particular option.

The text of the proposed rule is set forth below. **A list of Exchange-traded options indicating the maximum number of quoting participants per option is attached.** Questions concerning the new rule may be addressed to Richard S. Rudolph, Vice President and Counsel, at (215) 496-5074, or to Walt Smith, Vice President, Listings and Projects, at (215) 496-5532.

Brackets indicate deletions; underlining indicates new text.

Application for Approval as an SQT or RSQT and Assignment in Options

Rule 507. (a) No change.

(b) (i) –(ii) No change

(iii) In addition to the criteria described in this sub-paragraph, the Committee shall consider the following factors in making its decision concerning an application for assignment in an option when there are more applicants for assignment in a particular option than there are positions available:

- (A) the financial and technical resources available to the applicant;
- (B) the applicant's experience and expertise in market making or options trading;
- (C) the applicant's prior performance as a specialist, SQT or RSQT based on evaluations conducted pursuant to Exchange Rule 510.

(c) – (f) No change.

Commentary:

.01 RESERVED

.02. Maximum Number of Quoters (“MNQ”) in Equity Options. The term “MNQ” refers to the maximum number of participants that may be assigned in a particular equity option at any one time. The MNQ levels for options trading on the Exchange are as follows, based on the preceding month’s national volumes:

- (a) 20 for the 5% most actively traded options;
- (b) 15 for the next 10% most actively traded options;
- (c) 10 for all other options.

.03. Monthly Calculation of MNQ. Within the first five days of each month, a new MNQ will be set based on the previous month’s trading volume (“new MNQ”).

The following rules apply to those options for which the new MNQ decreases the previous MNQ:

- (a) If the number of assigned participants in the option on the last day of the month equals or is less than the new MNQ, then the previous

MNQ is reduced immediately to the new MNQ.

(b) If the number of assigned participants in the option on the last day of the month is greater than the new MNQ, then that option will have an “increased” MNQ equal to the number of assigned participants quoting electronically in that option on the last day of the month. If an assigned participant changes his/her appointment and ceases the assignment in that option, the “increased” MNQ will decrease by one until such time that the number of remaining assigned participants in that option equals the new MNQ. From that point forward, the number of assigned participants in the option may not exceed the new MNQ.

.04. Increasing the MNQ in Exceptional Circumstances: When exceptional circumstances warrant, the Committee may increase the MNQ for an existing or new product. “Exceptional circumstances” refers to substantial trading volume, whether actual or expected (e.g., in the case of a new product or a major news announcement or corporate event). Upon cessation of the exceptional circumstances, the Committee, in its discretion, may determine to reduce the MNQ, provided, however, that any reduction must be undertaken in accordance with the procedure established in Commentary .03 above with respect to lowering the “increased MNQ.” Any actions taken by the Committee pursuant to this paragraph will be submitted to the SEC in a rule filing pursuant to Section 19(b)(3)(A) of the Securities Exchange Act of 1934, as amended (“Exchange Act”).

.05 Announcements Regarding, or Changes to, MNQs. The Exchange will announce all changes regarding MNQ levels to the membership via Exchange Circular. The Exchange may increase the MNQ levels established in this Commentary by submitting to the SEC a rule filing pursuant to Section 19(b)(3)(A) of the Exchange Act. The Exchange may decrease the MNQ levels established in this Commentary upon SEC approval of a rule filing submitted pursuant to Section 19(b)(2) of the Exchange Act.