

NASD

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K STREET NORTHWEST • WASHINGTON D.C. 20006

September 28, 1976

I M P O R T A N T

NASDAQ OPTIONS PROPOSAL

TO: All NASD Members and Interested Persons

- RE:
1. Proposed Appendix E of Article III, Section 33 of the Rules of Fair Practice Concerning Transactions in Options;
 2. Proposed Amendment to Schedule D of Article XVI, Section 3 of the By-Laws Concerning NASDAQ System Rules and Regulations for NASDAQ Options;
 3. Proposed Amendment to Schedule C of Article I, Section 2(d) of the By-Laws Concerning Registration of and Qualifications for Registered Options Principals; and,
 4. Proposed Amendment to Article III, Section 30 of the Rules of Fair Practice Concerning Margin Requirements for Options.

Enclosed herewith are a proposed appendix to a new rule of fair practice, proposed amendments to two (2) existing schedules of the Association's By-Laws and a proposed amendment to an existing rule of fair practice which primarily concern the quotation display of options on the NASDAQ System and which provide for the regulation of members' transactions in options. These amendments and the new appendix have been proposed by the Board of Governors of the Association.

These proposals are being published by the Board at this time to provide members and other interested persons an opportunity to comment thereon. Comments on these proposals must be submitted in writing and be received by the Association not later than October 28, 1976 in order to receive consideration. After the comment period has expired, the proposals

and the comments will be reviewed by the Association's Options Committee and by the Board itself. If the proposals, or an amended version thereof, are at that time approved by the Board, they must then be submitted to and approved by the Securities and Exchange Commission pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended, prior to becoming effective.

Background and Explanation of Proposals

During the fall of 1975, the Board authorized an in-depth study of a proposal submitted to it by its Options Committee to develop a pilot program utilizing the NASDAQ System for quotation display of options on qualified exchange listed and over-the-counter securities. The study undertaken by the Committee and staff included, among other things, a survey of selected NASD members and a technical evaluation of the NASDAQ System. Based on an affirmative member response to proceed with the development of a NASDAQ option display system and a favorable system feasibility study which was reported to the Board, the Options Committee presented to the Board a package of rule proposals and amendments necessary to regulate members' transactions in NASDAQ displayed options. Included among these were the four proposals contained herein and a proposed new Rule of Fair Practice, Article III, Section 33. These five proposals were submitted to the membership for comment in Notice to Members No. 76-8, dated February 10, 1976.

Subsequent to the close of the comment period on March 16, 1976, the Board of Governors reviewed these proposals, taking into consideration comments received from the membership and interested persons, and made appropriate revisions thereto. Extensive revisions with respect to three of the proposals, proposed Appendix E of Article III, Section 33 of the Rules of Fair Practice and the proposed amendments to Schedule D of Article XVI, Section 3 and to Schedule C of Article I, Section 2(d) of the By-Laws, have prompted the Board to resubmit them for additional comment by the membership. They appear herein as revised along with the proposed amendment to Appendix A of Article III, Section 30 of the Rules of Fair Practice, which received no substantive comment and which remains as it appeared in Notice to Members No. 76-8. The proposed new Rule of Fair Practice, Article III, Section 33, received no substantive comment and, pursuant to the provisions of Article VII of the Association's By-Laws, after Board approval, was submitted to the membership for a mail vote in Notice to Members No. 76-24, dated July 22, 1976. Article III, Section 33 was approved by a majority of the members voting by a vote of 1,377 to 102. It has subsequently been submitted to the Securities and Exchange Commission for approval. That approval has not yet been received.

As described in Notice to Members No. 76-8, the Association's proposed options program contemplates that the NASDAQ System would be utilized for the display of quotations in certain options issued, or subject to issuance, by the Options Clearing Corporation (the "Clearing Corporation"). Subject to authorization by the Association, the options to be displayed will be limited to options in underlying securities selected in accordance with the guidelines and requirements of the Association, the Clearing Corporation and the Securities and Exchange Commission. The criteria will be virtually identical to that utilized in connection with the underlying securities of options traded on the various options exchanges. It is currently contemplated that, initially, options quoted on NASDAQ will be limited to over-the-counter underlying securities. Quotations for these options would only be permitted to be entered on the NASDAQ System by registered NASDAQ options market makers (options market makers) who would have to meet certain qualifications.

The terms of these options would be standardized as to exercise price and expiration date in accordance with the by-laws and rules of the Clearing Corporation. Accordingly, settlement and clearance would be accomplished through the facilities of the Clearing Corporation. Since trade comparison is not a function of the Clearing Corporation, that function would be accomplished for the Association by a designated third party processor.

The by-laws and rules of the Clearing Corporation provide that it may issue options for trading on facilities operated by, and perform options clearing functions for, those organizations which are participant owners of the Clearing Corporation. ^{1/} Thus, a necessary aspect of the Association's program is that it must become a participant owner of the Options Clearing Corporation. The Association thus contemplates acquisition of stock in the Clearing Corporation. This will take place subsequent to filing with and approval by the SEC of a NASDAQ Options Plan and after obtaining the approval of the Clearing Corporation's Board of Directors and existing participant owners.

Additionally, the Association's NASDAQ Option Program includes provisions for the last sale price reporting of completed transactions in NASDAQ option contracts. Accordingly, last sale trade price information will be reported by the NASDAQ System to the consolidated options tape administered by the Options Price Reporting Authority.

An essential ingredient in the Association's options program is the concept of a "dual market maker." Under this concept, market makers will be permitted to make markets simultaneously in both NASDAQ options and

^{1/} The existing participant owners, referred to hereinafter as "options exchanges," are the Chicago Board Options Exchange, the American Stock Exchange, Inc., the Philadelphia Stock Exchange and the Pacific Stock Exchange.

the underlying securities subject to such options. A member would not, however, be permitted to be a dual market maker unless the NASDAQ option group in respect to which a dual market is intended to be made and its underlying security each have a minimum of five (5) market makers. A group of options is defined as all option contracts of the same class of options having the same exercise price and unit of trading but separate expiration dates.

Due to the uniqueness of the dual market making function and the regulatory concerns inherent in such, the Association, on May 14, 1976, submitted a comprehensive memorandum to the SEC which analyzed the issues indigenous to dual market making and which outlined a regulatory environment in which dual market making should be allowed. On September 24, 1976, the SEC approved, in principle, the concept of dual market making as set forth in the Association's memorandum. Commentators when reviewing the rule proposals and their explanations should carefully study the requirements and annotations thereto concerning dual market making. These provisions are new and appear for the first time for membership comment.

In reviewing and commenting on the enclosed package of proposed rule amendments, reference should be made to Notice to Members No. 76-8. Where appropriate, the section-by-section analysis of the enclosed proposals which follows will indicate the sections and subsections which differ substantially from those which appeared in that notice.

Commentators should also be mindful of the manner in which these proposals were formulated. The Board's intent was to have an option contract subject to quotation display on NASDAQ that was comparable in most respects to the exchange listed options. Accordingly, in developing the rules, the Board sought to provide for uniform and equal regulation of options trading irrespective of the marketplace in which an option is traded; hence, commentators will find these proposed rules comparable to provisions presently embodied in exchange options trading systems. An important difference, however, is that the basic components of the over-the-counter market are preserved in that the NASDAQ options secondary markets will be free and open and will be maintained by independent competitive market makers. It is currently anticipated that the Association's options program will become operational during the second quarter of 1977.

Further, the provisions of the proposed rules would embrace transactions executed on options exchanges by non-members of such exchanges and extend to "conventional" or "traditional" option transactions effected by all members.

A section-by-section analysis of the proposals commences on the following page.

All comments should be addressed to Mr. Thomas D. Walsh, Secretary, National Association of Securities Dealers, Inc., and received by the Association by October 28, 1976, in order to receive consideration. All comments will be available for inspection. Questions should be addressed to Messrs. S. William Broka (202) 833-7356 or David P. Parina (202) 833-7247.

Sincerely,

A handwritten signature in cursive script, appearing to read "Frank J. Wilson".

Frank J. Wilson
Senior Vice President
Regulatory Policy and
General Counsel

EXPLANATION OF PROPOSALS

Appendix E of Proposed Article III,
Section 33 of the Rules of Fair Practice

Options Rules

Subsection (a) of Section 1 would specify which option transactions would be subject to the provisions of Appendix E. Specifically, subsection (a)(1) would embrace all transactions in options issued, or subject to issuance, by the Options Clearing Corporation that are displayed on the NASDAQ System. Subsection (a)(2) would cover all transactions in options listed on an exchange which are transacted by members who are not members of such exchange. Subsection (a)(3) would make the provisions of Appendix E applicable to members' transactions in conventional options. This Section has been revised from that originally proposed in order to subject the option transactions of "access firms" (firms who execute transactions in exchange listed options but who are not members of the exchange on which the option is listed) to the Rules of this Appendix and to embrace members' transactions in conventional options. Transactions in exchange listed options by members of the exchange on which the option is listed would not be subject to the provisions of Appendix E.

The Board notes that approximately 400 firms are presently engaged in exchange options activity through clearing members of the various options exchanges while not being members of the respective exchanges themselves. The consequence of such is that the regulatory features embodied in the series of specialized options rules which apply to exchange members do not apply to these access members dealing in exchange listed options. The Board is of the view that this regulatory void should be eliminated. It has, therefore, rewritten Appendix E so as to include them within the scope thereof.

Subsection (b) establishes that the provisions of the By-Laws and Rules of Fair Practice of the Association, to the extent applicable, would also apply to the trading of option contracts.

Subsection (c) specifies the meaning of local time as used throughout Appendix E. It should be noted that all times referred to in Appendix E are consistent with and conform to the times specified in comparable situations on the various options exchanges.

Section 2 would contain the definitions of terms used throughout Appendix E. The definitions are self-explanatory. Members should be aware that the terms opening purchase transaction, opening writing transaction,

closing sale transaction, and closing purchase transaction, which are defined in paragraphs (u), (v), (w) and (x), respectively, have no relationship to the first and last trade of a particular trading day in options. Rather those terms relate solely to the nature of an option position created or liquidated by a transaction for a particular account and are consistent with the use and definition of those terms on the various exchanges trading option contracts. The same applies to many of the other definitions found in Section 2. Definitions contained herein, which did not appear in the original proposals, include group of options, spread order and dual market maker. These terms are defined in paragraphs (m), (hh) and (ii), respectively. The Board has deleted the definition of primary market, which appeared originally as paragraph (z), as a result of membership comment. The Board concurs with the view that the determination of primary market should be left to members.

Members should specifically note the new definition of "dual market maker." Commentators are urged to closely review provisions in respect to such and comment accordingly. These provisions are found in Sections 2(ii), 3(b), 5(f) and 9 of proposed Appendix E and Section 3(e) of Schedule D. Together they establish a regulatory framework for the new concept. In addition, new market surveillance techniques are being developed to more closely monitor activities of dual market makers.

Section 3(a) establishes position limits which would prohibit any member, associated person of such member or public customer from creating positions in any series or class of options through opening transactions (purchase or writing) in excess of limits established from time to time by the Association. These limits initially would be 1,000 option contracts of the same class of options and 500 option contracts of the same class and the same expiration date. The limits established are comparable to the limitations imposed by the options exchanges. Subsection (b) establishes separate position limits for the trading accounts of dual market makers which would prohibit any dual market maker from creating aggregate long or short positions in its trading account in any series of options or an aggregate uncovered short position in any series of options in excess of a specified percent of the outstanding option contracts for that series. Presently, a study is being undertaken by the Board's Options Committee to determine the appropriate percentage. This subsection is new. When reviewing this subsection, members are asked to comment on its regulatory aspects and on the application of its provisions.

The regulatory objective of Section 3 is to prevent any person or group of persons from achieving a position in options which would create the potential for manipulation in a particular class or series of options, or in the underlying security. Further, due to the increased interest in standardized options and the presence of secondary markets for them, it is believed that without these regulatory safeguards the possibility for manipulation by means of "cornering the market" in a particular class or series of options would be greater.

Section 4 would establish a limitation on the number of long positions which may be exercised within five (5) consecutive business days by a member,

person associated with a member or public customer. These limits are currently 1,000 option contracts within any five (5) consecutive business days and are comparable to limitations established by the options exchanges. Section 4 would provide for exceptions to these limitations with the prior written approval of the Association. The regulatory objective of exercise limitations is to assist in the prevention of price manipulations of the underlying security by restricting the number of options which may be exercised in a short period of time. These limitations should minimize the effect exercises may have on the market price of the underlying security.

Section 5 would establish reporting requirements relative to option positions maintained by a member, associated person of a member and public customer.

Subsection (a) would require a member to file a report with the Association containing information regarding each account maintaining positions in excess of 100 option contracts of any single class of options. The report would be required to be filed not later than the close of business on the business day following the day on which the transaction or transactions caused the account to be in excess of the established standard. The objective of this provision is to enable the Association to monitor situations where excess positions have been acquired and to monitor the liquidation thereof pursuant to Section 6 of this Appendix.

Subsection (b) would establish as a duty of each member the prompt reporting to the Association of any case in which the member has knowledge that a person or persons have exceeded or are attempting to exceed the position or exercise limits established pursuant to Sections 3 and 4, respectively.

Subsection (c) would require the member to report monthly uncovered short positions to the Association. The regulatory objective of this provision is to monitor the financial exposure uncovered positions present to the member, its clearing member and the Options Clearing Corporation. Appropriate regulatory action could, therefore, be taken.

Subsection (d) specifies that members determined to be subject to the reporting requirements of Section 5, as well as all members who effect option transactions for their own account amounting to five (5) or more contracts of the same class during any trading session, shall report on a form prescribed by the Association such transactions on a basis and frequency to be established for such members by the Association. This provision allows the Association to be flexible in establishing reporting frequency and also permits the close monitoring of situations in which a member executes a stated number of transactions for its own account in the same class of options during the same trading day.

Subsection (e) would exempt the trading accounts of registered NASDAQ options market makers from the provisions of subsection (d). This subsection is new and was added as a result of membership comment on the original proposals.

Subsection (f) would require dual market makers to report information to the Association with respect to transactions and positions in conventional options on underlying securities in which NASDAQ displayed options are being traded. This subsection is new and was added by the Board in order to reduce the possibility of manipulation by a dual market maker through use of conventional options.

As originally proposed, the position limits outlined in Section 3, the exercise limits outlined in Section 4 and the option positions maintained by members which would require reporting pursuant to subsection (a) of Section 5 above, were to have been contained in a schedule attached to proposed Appendix E. In order to eliminate the necessity of such a schedule, these specific limits have been placed in Appendix E itself.

Sections 6 through 8, discussed below, originally appeared as Sections 9 through 11 of proposed Part X to Schedule D of Article XVI of the By-Laws. Since they would more appropriately be part of Appendix E, they have, been relocated.

Section 6 would provide authority to require a person or a group of persons acting in concert, who hold or control, or who are obligated with respect to an aggregate position in options which exceeds the position limits established by the Association pursuant to Section 3 hereof, to liquidate that portion of the position in excess of such limitations. Subsection (a)(1) would specify that upon a determination that a member has an excess position, the Association shall orally notify such member that it holds a position in options which exceeds the limits established pursuant to Section 3 and advise the member that pursuant to these rules the member has seven (7) calendar days from the date of such oral notification to reduce his excess position. This subsection specifies that this notification shall be confirmed forthwith in writing and that the member would be required to communicate to the Association within five (5) calendar days of the oral notice his intentions with regard to the elimination of the excess position and to thereafter report to the Association when the elimination of the excess position has been accomplished.

Subsection (a)(2) provides that the Association shall, upon its determination that any other person, including a public customer, either acting along or in concert with others, holds or is obligated in respect of options in excess of the position limits established pursuant to Section 3, orally direct the member or members with whom such person or persons has an option contract to orally notify such person advising that the Association has determined that an excess position exists. Further, the member would be required to advise such person that, within seven (7) calendar days of the oral notification, the excess position maintained by such person shall be reduced to eliminate the excess position. Such notification shall

be confirmed forthwith in writing. Further, such written notification shall advise such person to communicate to the member or members with whom options accounts are maintained, and to the Association, his intention with regard to the elimination of the excess position.

It is believed that subsections (a)(1) and (a)(2), in addition to serving to eliminate positions in excess of that determined to be in the public interest, because of the notice provisions contained therein, adequately protect the rights of persons who may be the subject of such notices to contest the determination that an excess position exists. Appropriate due process protections are therefore accorded before disposition of the excess position would be required.

Subsection (b) provides that the Association may, where it determines that such is necessary in the public interest and necessary for the protection of investors and the maintenance of a fair and orderly market, direct an oral or written notice to members advising them of any person or persons determined to hold a position in options which exceeds the limits established pursuant to Section 3. Once such notice has been issued, a member shall not accept an order for the account of the person or persons named in the directive which would have the effect of increasing the excess position of such person unless express approval for such transaction is given by the Association or until such directive is rescinded.

Section 7 would authorize the Association to establish restrictions with respect to uncovered short positions. It would specify that, whenever the Association determines in light of current market conditions for options and underlying securities that there exists an excessive number of uncovered short positions in option contracts of a given class, or that an excessively high percentage of outstanding short positions in option contracts of a given class are uncovered, the Association may, upon determining that such is in the public interest and necessary for the protection of investors and the maintenance of a fair and orderly market, prohibit any further opening writing transactions in option contracts of that class unless the resulting short position is covered. Further, this section would authorize the Association to prohibit the uncovering of any existing covered short positions in option contracts of such a class. The Association may exempt transactions of registered NASDAQ options market makers from restrictions imposed under this Section any may rescind such restrictions if it is determined that they are no longer appropriate.

Section 8 would authorize the restriction of transactions in out-of-the money options. Subsection (a) would authorize the Association to restrict opening transactions in any call option wherein the exercise price of an option in a given series is more than \$5 above the representative bid of the underlying security for such call option on the last previous day in which the underlying security was traded and the representative bid of such call option

was less than \$. 50 per unit of trading on the last previous day on which such call option was traded. Specific limits in subsection (a) with respect to the difference between the exercise price of an option in a given series and the representative bid of its underlying security and with respect to the representative bid of the option on the last previous day on which it was traded are new and have been added by the Board to reflect the elimination of the proposed schedule to Appendix E.

Subsection (b) would establish certain exemptions to the limitations prescribed under subsection (a). Subsection (b)(1) would provide that the restrictions would not be applicable to covered opening writing transactions and subsection (b)(2) would exempt spread orders for the purchase and sale of the same number of option contracts of the same class.

Subsection (c) would authorize modifications of the provisions set forth under subsections (a) and (b) where determined necessary for the public interest and the maintenance of a fair and orderly market in option contracts. Subject to certain proscriptions, any exception or modification would not become effective earlier than 15 minutes after it is displayed on NASDAQ and such would not remain in effect for more than two (2) business days unless ratified by a committee of the Board authorized to do so. Further, all action taken under the authority of subsection (c) and the reasons therefor must be reported to the designated committee not later than the business day immediately following the one on which such action is taken.

Subsection (d) would contain authority to impose restrictions on option transactions or the exercise of option contracts in one or more series of options of any class upon a determination that such action is necessary in the interest of maintaining a fair and orderly market in the option contracts, or in the underlying security, or is otherwise necessary in the public interest. It would further provide that there could be no restrictions during the ten (10) business days prior to the expiration date of a given series of options with respect to the exercise of such option contracts.

Sections 9 through 19 below appeared in the original proposal as Sections 6 through 16. They have been renumbered as a result of the inclusion in proposed Appendix E of new Sections 6 through 8 which, as noted above, originally appeared in proposed Part X of Schedule D.

Section 9 would prescribe the nature of information which would be required to be on the confirmation to be furnished by a member to a customer relative to an option transaction. These provisions are comparable to the requirements concerning general securities transactions. However, due to the unique features of options, some additional information is required. Further, it is the Board's view that the principle of full disclosure is of paramount importance where a member acts as a market maker for both the

option and its underlying security. Accordingly, a new provision requiring the disclosure of this fact on confirmations sent to customers has been added.

Section 10 would require that a current prospectus of the Options Clearing Corporation be delivered to a customer engaging in transactions in options issued by the Options Clearing Corporation prior to the time his account is opened for options trading. If the Options Clearing Corporation issues a new prospectus or supplement to the current prospectus, it must be distributed to each such customer either at the time such material is issued or not later than the time a trade is entered on behalf of the customer. The regulatory objective intended by this provision is to make the investor aware of the business and financial condition of the issuer, the nature of the options which are the subject of the transaction, and the inherent risks attendant to the purchase and sale of options.

Section 11 would prohibit a member from entering into an option contract with an issuer, control person or affiliate of an issuer, among others, if the option transaction of that issuer would involve the underlying security of the issuer. The conflict created by such a situation is apparent and, hence, should be prohibited.

Section 12 prohibits any member from accepting for the purpose of covering a short position, satisfying margin requirements or complying with an exercise notice, shares of underlying securities which may not be sold by the holder thereof except upon registration pursuant to the provisions of the Securities Act of 1933 or pursuant to SEC rules promulgated under the Securities Act of 1933. This prohibition is necessitated by the obvious impediment to full transferability of the securities in question. An investor when investing in an option bargains in good faith that the underlying securities are fully transferable and not subject to restrictions.

Section 13 would require a member to send a monthly statement of account to each public customer having a transaction in, or an entry with respect to, an options account that occurred in the previous month. Further, this section would require that a quarterly statement of account be forwarded to each public customer having an open position or money balance in an options account.

Section 14(a) would prohibit a member or person associated with a member from accepting an order from a public customer for the purchase or writing (sale) of an option contract unless the account of the public customer has been approved in a manner consistent with the provisions of Sections 14(b) and 14(c) for option transactions. Thus, notwithstanding that a customer has an open account with a member, option transactions could not be effected therein until specific approval for such had been granted by

the member being mindful of the provisions of subsections (b) and (c) of Section 14 which require, among other things, that such approval be by a Registered Options Principal.

Subsection (b) would require that prior to approval of a public customer's account for option transactions, a member and persons associated with a member shall exercise due diligence to determine the essential facts relative to the financial situation and investment objectives of the public customer. The rule would require that a Registered Options Principal, who is personally informed of such facts, approve in writing the public customer's account for the trading of options. The rule would provide that in the case of a branch office the public customer's account may be approved by the manager of the office, with the stipulation that such account must be approved by a Registered Options Principal within seven (7) business days.

Subsection (c) further requires that within fifteen (15) days after the account of a public customer has been approved for option transactions, the member must obtain a written agreement from the customer which states that the public customer is aware of and agrees to be bound by, the rules and by-laws of the Association and if he is to engage in transactions in options issued by the Options Clearing Corporation, its rules. As originally proposed, subsection (c) would have required a member to obtain the written agreement from a customer prior to opening such customer's account for option transactions. The modification to provide for the agreement to be obtained within fifteen (15) days of the opening of an account was made as a result of membership comment on the original proposal. The regulatory intent of this provision is to provide the Association with the means by which the position and exercise limits may be applied and enforced against the account of a public customer. This provision is not intended to provide the Association with disciplinary authority over the account of a public customer but would permit it to, for instance, require the liquidation of excess positions.

Section 15 would prohibit a member or person associated with a member from exercising discretionary authority in the account of a public customer unless the provisions of Article III, Section 15 of the Rules of Fair Practice relative to discretionary accounts and subsections (a)(1) through (a)(3) of Section 15 of Appendix E have been complied with.

Subsection (a)(1) would require the member to obtain written authorization from a public customer specifically authorizing discretionary option transactions in that customer's account. Subsection (a)(2) would require that the account of the public customer must be accepted for the member as a discretionary account by a Registered Options Principal and subsection (a)(3) would require a Registered Options Principal to approve every discretionary order for option transactions. The rules would provide that, in the case of a branch office, a discretionary option order may be approved and initialed on the date of entry by the branch office manager, provided, however, that the approval is subsequently approved by a

Registered Options Principal within five (5) business days. The requirements of this subsection would not apply to the use of discretion in respect to the price or time at which an order given by a customer for the purchase or sale of a definite number of option contracts is executed. The Board believes that the risks inherent in options trading are such that discretionary trading in options should be closely monitored by members and a specific obligation should be placed upon management to affirmatively approve each discretionary order entered on behalf of a customer by its representatives.

Subsection (b) would require a member to make and maintain a record of each discretionary option transaction. The record would reflect the fact that discretionary authority was exercised and would contain other pertinent data.

It should be emphasized that the provisions of proposed Section 15 would be in addition to the existing provisions of Article III, Section 15 of the Rules of Fair Practice relating to discretionary accounts.

Section 16 would establish suitability requirements in respect to a member's recommendation to a public customer for the purchase or sale of an option. These provisions are more stringent than existing requirements and they should be closely studied by commentators. Subsection (a) would require the member to make a reasonable inquiry as to a public customer's investment objectives, financial situation and needs and any other information deemed necessary to assure that any recommended option transaction would not be unsuitable for such public customer.

Subsection (b) would prohibit a member from effecting on behalf of a public customer an uncovered writing transaction unless the member has reason to believe, based upon reasonable and diligent inquiry, that such customer is capable of evaluating the additional risks attendant to such transaction and that such customer has the financial capability to meet the potential financial requirements related to such a contract (margin calls).

Section 17 would require a Registered Options Principal of a member to supervise the accounts of public customers and all orders in such accounts related to option transactions. The Registered Options Principal would, therefore, be charged with the responsibility of closely monitoring all of a member's options business.

Section 18 would prescribe that violations of the rules, regulations or by-laws of the Options Clearing Corporation by a member or person associated with a member engaged in transactions involving options issued, or subject to issuance, by the Options Clearing Corporation, could be deemed conduct inconsistent with the just and equitable principles of trade and a violation of Article III, Section 1 of the Association's Rules of Fair Practice. Thus, members engaging in such transactions would be obligated to adhere to applicable Options Clearing Corporation rules.

Section 19 would provide that the provisions of certain sections under Article III of the Rules of Fair Practice would be specifically applicable to option transactions. It also recognizes that certain of those rules do not and should not apply. To reinforce the applicability of the stated rules to options, Section 19 also specifies that whenever the terms "security" or "securities" are used in the delineated sections, such should also be construed to mean options.

Proposed Part X
to Schedule D of
Article XVI of the By-Laws

Schedule D of the By-Laws would be amended by adding a new Part X which would embody system requirements as they pertain to the display of options on the NASDAQ System.

Section 1 would define "authorized underlying security," "NASDAQ option contract" and "unit of trading" and would further note that unless the context otherwise requires, or unless defined therein, the terms used in Part X of Schedule D shall have the meanings as defined in Section 2 of Appendix E to Article III, Section 33 of the Rules of Fair Practice. The term NASDAQ option contract is new and has been added to enable the Association to differentiate between the option transactions of members which are subject to the rules of Appendix E and those particular option transactions which are subject to the requirements of proposed Part X of Schedule D. The term unit of trading has been added because it is referenced within the schedule and was inadvertently omitted from the original proposal. The definitions as contained in proposed Appendix E have been referenced herein to specifically provide coverage for many of the terms used within this part of the schedule.

Section 2 would establish the level of services available for options displayed on the NASDAQ System. Subsection (a) would provide that a Level I subscriber would have access to representative bid and ask quotations for each NASDAQ option on which a minimum of two registered NASDAQ options market makers are currently quoting the option. Therefore, in the event only one market maker would be entering quotations for a specific option, the NASDAQ System would not release quotations for that option to Level I subscribers.

Subsection (b) would provide that a Level II subscriber would have access to quotations currently entered by all registered NASDAQ options market makers, irrespective of the number of market makers.

Subsection (c) provides that a Level III subscriber would be able to enter quotations into the NASDAQ System for NASDAQ options upon approval by the Association. Level III subscribers would also have access to all option quotations entered into the NASDAQ System.

The provisions of Section 2 are consistent with comparable provisions presently contained in Schedule D relative to general securities quotations. The operation of the system as it relates to NASDAQ options will, therefore, be essentially the same as for general securities. Last sale reporting would, however, be required. Such will be described below.

Section 3 establishes registration, qualification, and other requirements applicable to registered NASDAQ options market makers and other members. Subsection (a) requires a member to submit an appropriate application to the Association prior to becoming registered as a NASDAQ options market maker.

Subsection (b) would establish a minimum net capital requirement for each registered NASDAQ options market maker of \$50,000 and an additional net capital of \$5,000 per options series quoted up to a maximum requirement of \$150,000. This proposed minimum net capital requirement was reduced to \$50,000 from the original requirement of \$100,000. The Board believes this revised minimum requirement, even though doubling the present minimum net capital requirement set forth in SEC Rule 15c3-1, will permit more small broker-dealers to participate as options market makers than would be possible with a \$100,000 minimum. The maximum net capital requirement was increased to \$150,000 so that those members which became involved in several series of option contracts would be required to maintain capital sufficient to sustain such a commitment.

Subsection (c) would require each registered NASDAQ options market maker either to be a clearing member of the Options Clearing Corporation or to establish a clearing arrangement with a clearing member of the Options Clearing Corporation. This is essential since the Options Clearing Corporation requires one day settlement on all contracts. They must be fully settled with OCC by 10:00 a.m. Eastern Time on the day following the date of the trade.

Subsection (d) would require each registered NASDAQ options market maker to have a Registered Options Principal. The duties of a Registered Options Principal are specified in amendments to Schedule C of the By-Laws, discussed hereafter.

Subsection (e) would specify that, before a member became a dual market maker, both the NASDAQ group of options in which the member desires to make a dual market and the underlying security thereof, must be represented by a minimum of five market makers registered as such with the Association.

Subsection (f) would relate to the character of option quotations to be displayed on the NASDAQ System. Subsection (f)(1) would require all bids or offers for options issued by the Clearing Corporation displayed on the NASDAQ System to be for at least one NASDAQ option contract representing the minimum unit of trading, i. e., one option covering 100 shares of the underlying security.

Subsection (f)(2) would require all bids or offers for options issued by the Options Clearing Corporation displayed on the NASDAQ System to be expressed in terms of dollars per share of the underlying security. Subsection (f)(2) would further provide bids and offers for a NASDAQ option contract subject to an adjusted unit of trading to be expressed in terms of dollars per the appropriate fractional part of the total securities constituting the adjusted unit of trading.

Subsection (f)(3) would require a registered NASDAQ options market maker who receives a buy or sell order to execute a trade for at least one option contract at the quotation he has displayed on NASDAQ at the time of receipt of the order. He would, therefore, be committed to the quotation he has displayed on the screen to the extent of at least one contract at the quoted price.

Subsection (g) would establish a real time trade reporting requirement for transactions in NASDAQ displayed options executed by a registered NASDAQ options market maker and other members. Real time trade reporting will be new to the NASDAQ System. Such reporting is presently being effected by the various exchanges as part of the program of the Options Price Reporting Authority (OPRA). The Association program would conform therewith.

Subsection (g)(1)a. would require a member to transmit reports of writing (sale) transactions in NASDAQ options executed during the trading hours of the Options Price Reporting Authority (OPRA) within one and one-half minutes after execution of the transaction. Reports not transmitted within one and one-half minutes after execution shall be designated as late. This is consistent with OPRA's requirements. Reports of writing (sale) transactions executed outside of OPRA's trading hours would be reported weekly in writing to the NASDAQ supervisory office in New York City. This paragraph has been modified somewhat from the original proposal in which reporting requirements would have been limited to registered NASDAQ options market makers. The purpose of such modification was to ensure that all trade information for NASDAQ options be reported for inclusion on the OPRA Tape. This same reasoning has also been applied to extend the reporting requirements of subsection (g)(1)c. and (g)(2) below to all members, not only those who are registered NASDAQ options market makers.

Subsection (g)(1)b. would require each reported writing (sale) transaction to reflect the recorded price on the trade ticket exclusive of commissions, taxes or other charges.

Subsection (g)(1) c. would exempt a member from reporting option transactions executed on an exchange. The reason for this is that such transactions would have already been reported on the exchange where executed.

In addition to real time transaction reporting, other reports will be required. Subsection (g)(2) provides that a member shall report weekly and/or monthly such data on NASDAQ options quoted in the system as the Board of Governors may require. The Board would thus have the authority to order additional reports as necessary. Subsection (g)(3) would require that trade tickets on transactions in NASDAQ options be time stamped at the time of execution.

Subsection (h) would require a registered NASDAQ options market maker to be open and active between 10:00 a. m. and 4:00 p. m. Eastern time. A registered NASDAQ options market maker would be able to enter quotations into the NASDAQ System outside its normal business hours, providing the system is operating, and would also be permitted to execute transactions. Such transactions would be considered to be next day transactions for settlement purposes, however.

Subsection (i) provides that the registration of a NASDAQ options market maker would become effective on the second business day following receipt of its registration application by the Association unless the applicant is notified by the Association that its registration is not effective. In the event said registration is for a NASDAQ option not authorized by the Association, the registered NASDAQ options market maker's registration would not become effective until the start of business on the first day such NASDAQ option is authorized for quotation by the Association.

Subsection (j) would establish withdrawal procedures for the removal of quotations by a registered NASDAQ options market maker from the NASDAQ System. Subsection (j)(1) would permit a registered NASDAQ options market maker to suspend or remove its quotations from the NASDAQ System for a specific period of time upon demonstrating to the Association, and receiving its approval, that circumstances warrant suspension or withdrawal of quotations.

Subsection (j)(2) would prohibit a registered NASDAQ options market maker who has withdrawn its quotations from re-entering quotations during the same day without receiving the prior approval of the Association. Subsection (j)(3) would terminate the registration of a registered NASDAQ options market maker for each NASDAQ option wherein the market maker withdrew quotations, at or before the daily close of the system, without the prior approval of the Association.

Subsection (j)(4) would permit, subject to certain restrictions, a registered NASDAQ options market maker, upon application to and approval by the Association, to resume display of quotations on the NASDAQ System for the NASDAQ option in respect to which such market maker's registration was terminated. The registered NASDAQ options market maker would not, however, be permitted to resume quotations in the series of options for which its registration had been terminated until after one-half of the time remaining to the expiration date of that series of options has expired. This subsection further provides that this period could not be less than one week nor greater than one month.

Subsection (k) would permit a registered NASDAQ options market maker to withdraw from the NASDAQ System and voluntarily terminate its

registration as to any series of options by withdrawing quotations from the NASDAQ System.

Subsection (1) would grant authority to the Association to suspend and/or terminate the registration of a NASDAQ options market maker. Subsection (1)(1) would authorize the Association, upon notice, to suspend a registered NASDAQ options market maker's authority to enter quotations into the NASDAQ System for up to two consecutive business days where extraordinary circumstances are deemed to exist and where the Association believes such action is required to promote just and equitable principles of trade. The period of suspension could be extended by the Association for successive periods of two consecutive business days, as necessary, if the Association is engaged in an investigation of the registered NASDAQ options market maker's activities in connection with the suspension of quotations and such investigation has not been completed. These provisions are consistent with current provisions of Schedule D relating to general securities.

Subsection (1)(2) would authorize the Association, pursuant to its Code of Procedures for Handling Trade Practice Complaints, to suspend or terminate the registration of a registered NASDAQ options market maker in one or more NASDAQ options for violation of any applicable Rules of Fair Practice or applicable rules of Schedule D.

Section 4 provides that the Association may approve for display on the NASDAQ System, only option contracts on underlying securities which have been selected as meeting the criteria specified in Section 6. Section 4 further specifies that such contracts shall be designated as to the type of option, the underlying security, the expiration month and the exercise price.

Section 5 would authorize the Association to establish a series of options open for trading after a class of options has been approved for display on NASDAQ. Subsection (a) would authorize the establishment of the expiration month and exercise price of option contracts included in each series of a class of options that has been approved. When a class of options is first displayed, a series of options having three different expiration months would normally be opened. The expiration cycles would run in 3, 6 and 9 month periods after a given series is opened. Pursuant to the provisions of this section, it is presently contemplated that the striking prices of the NASDAQ options would be fixed at 5 point intervals for underlying securities trading below \$50; 10 point intervals for underlying securities trading between \$50 and \$100; and 20 point intervals for underlying securities trading above \$100. New series of options may be opened with the same expiration dates but with different striking prices to reflect price movements of the underlying security. The striking prices of such options will be set at prices which are reasonably close to prices of the underlying security at the time the series is opened for trading but in no event will the striking price be less than \$10. This procedure

and the establishment of striking prices conforms to practices followed by the options exchanges. The insertion of a minimum exercise price of \$10 does, however, represent a change from the original proposals, which contained no such minimum.

Subsection (b) would restrict the trading in a series of NASDAQ options on the business day prior to expiration date for the particular series. No transaction would be permitted after 3:00 p.m. Eastern Time on such date.

Subsection (c) would provide that adjustments in options which may be due to acquisitions, mergers or stock dividends will be made by the Options Clearing Corporation in accordance with its rules. When so adjusted, this subsection provides that the adjusted unit of trading and the adjusted exercise price would be applicable with respect to all subsequent transactions in that series of options.

Section 6 would establish the qualifications for authorized underlying securities that would be eligible to be subject to NASDAQ options. Subsection (a) would provide that only the Association will determine the authorized underlying securities for NASDAQ options. Such will be done in accordance with its agreement with the Options Clearing Corporation, and in accordance with the specific criteria set forth in this Section. The criteria set forth in subsections (a)(1) through (a)(5) and (b)(1) through (b)(4) of Section 6 are self-explanatory.

Subsection (c) would enable flexibility for those occasions which may arise from time to time that justify an exception to one or more of the criteria. Thus, in an exceptional situation an underlying security which did not meet in detail each and every one of the listing criteria could still become an authorized underlying security.

Subsection (d) did not appear in the original proposals. As proposed, it would establish the criteria which must be met in order for a security to continue to qualify as an authorized underlying security for NASDAQ options. These criteria are presently being developed in conjunction with the Securities and Exchange Commission and the options exchanges.

Section 7 would establish the unit of trading for each series of options displayed on NASDAQ as that unit of trading established by the Options Clearing Corporation pursuant to its rules. The unit of trading under OCC's rules has presently been established as one contract representing 100 shares of the underlying security for all series of options.

Section 8 relates to the suspension of an authorized underlying security and/or its options from display on the NASDAQ System. Subsection (a) would specify that the Association may suspend an authorized underlying security and/or its NASDAQ option from quotation on the NASDAQ System if it

deems such necessary and appropriate for investor protection and the prevention of fraud and manipulation and, among other things, upon the occurrence of one or more events specified in subsection (b).

Subsection (b) sets forth certain events, the occurrence of which may subject an authorized underlying security and/or its option to suspension from the NASDAQ System. These events, set forth in subsections (b)(1) through (b)(4) are self-explanatory.

Subsection (c) would allow for exceptions to the application of the criteria set forth in subsections (a) and (b) if such were considered necessary and appropriate in the public interest.

As noted in the explanations with respect to Appendix E of Article III, Section 33 of the Rules of Fair Practice, the three Sections which originally appeared as Sections 9 through 11 of Schedule D now appear as Sections 6 through 8 of Appendix E.

The explanations with respect to new Sections 9 through 11 hereof did not appear in the original Schedule D proposal, since the specific language of these Sections had not been developed at the time Notice to Members No. 76-8 was sent to the membership. Section 9 through 11 are therefor appearing for the first time for membership comment.

Section 9 would establish the trade comparison procedures for NASDAQ options.

Subsection (a) describes the scope and applicability of the trade comparison procedures relative to transactions in NASDAQ options. Every over-the-counter transaction in a NASDAQ option, whether by a clearing member or by a non-clearing member through a clearing member, would be required to be reported to the Association or its designee for trade comparison pursuant to procedures established by the prospectus issued by the Options Clearing Corporation. All compared NASDAQ option transactions would then be submitted to the Options Clearing Corporation for clearance and settlement purposes. Accordingly, they will be subject to the rules of the Options Clearing Corporation applicable thereto.

Subsection (b) would provide that a clearing member would be responsible for the clearance and settlement of each of its NASDAQ option transactions, as well as the NASDAQ option transactions of the members for which it clears. Therefore, the clearance and settlement of NASDAQ option transactions will not be the responsibility of the Association or its third party processor.

Subsection (c) establishes specific trade reporting and comparison procedures. Paragraph (1) would require the clearing member on trade date to report each NASDAQ option transaction to the Association (or its third party processor). These transactions will be reported at a location, time and in a manner specified by the Association.

Paragraph (2) provides that the Association (or its third party processor), upon receipt of the clearing member's NASDAQ option transaction report, would compare and match these transactions.

Paragraph (3) provides that the Association (or its third party processor) will make available daily reports summarizing transactions submitted to it by the clearing member for each NASDAQ option and each account maintained by the clearing member. The reports to be furnished to the clearing member will reflect compared trade items, uncomparing trade items and trade advisories.

Paragraph (4) provides that upon the clearing member's prompt review of each report, the clearing member shall reconcile all uncomparing, advisory, or erroneous trades and report such reconciliation to the counterparty of the transaction and to the Association (or its third party processor). This report would be made by the clearing member as soon as possible, but in no event later than the time prescribed by the Association. This paragraph further provides that the accuracy of all reports submitted to the clearing member by the Association (or its third party processor) shall be the sole responsibility of the clearing member.

Paragraph (5) provides that subsequent to the cut-off time established by the Association, a final unreconciled trade report, containing remaining uncomparing and advisory trades, will be supplied to the clearing member. Any of these trades which the clearing member can resolve prior to 10:00 a.m. Eastern time of the next business day shall be reported to the Association (or its third party processor) on that day in accordance with the provisions set forth in paragraph (1), above.

It should be noted that times prescribed by the Association throughout this Section are necessary to conform with the requirements of the Options Clearing Corporation for next day settlement on all transactions in options issued by it.

Paragraph (6) provides that in the event an uncomparing trade cannot be resolved prior to 10:00 a.m. Eastern time on the first business day following the trade, the clearing member shall close out such transaction according to provisions set forth in paragraph (7).

Paragraph (7) provides that an uncomparing trade of the nature contained in paragraph (6) must be resolved by 3:30 p.m. Eastern time on

the first business day following the trade date. Members representing purchasers in such trades shall enter into a new NASDAQ option transaction to purchase the option contract which was the subject of the uncom-
pared trade and members representing writers in such trades shall enter into a new NASDAQ option transaction to sell the option contract which was the subject of the uncom-
pared trade. The uncom-
pared trade will be nullified once this action has been taken and once the appropriate reversing transactions closing out the original uncom-
pared trade have been submitted to the Association (or its third party processor). Any claims for damages resulting from uncom-
pared NASDAQ option transactions must be made promptly and only for the accounts of the members involved, not the ac-
counts of their respective customers.

Section 10 would establish clearance and settlement procedures for NASDAQ options.

Subsection (a) establishes the procedures to be followed by a clearing member in the event a compared NASDAQ option transaction is rejected by the Options Clearing Corporation due to the failure of a clearing member acting on behalf of the purchaser to make a premium payment. The clearing member representing the seller (writer) can either cancel such transaction or enter into a new opening writing transaction or closing sale transaction for the same option contract. Any losses in connection with the new transaction shall be the responsibility of the defaulting clearing member. The action required by this subsection would have to be taken before the close of trading on the day such transaction was rejected by the Options Clearing Corporation unless such time is extended by the Association.

Subsection (b) provides that, in the event a non-clearing member is suspended by the Association, all open short positions in option contracts and open positions resulting from the exercise of option contracts, other than fully secured positions, for such suspended member shall be closed out promptly by all members carrying such positions for the account of such member. The rule provides that, in the event a clearing member of the Options Clearing Corporation is suspended by the Association, the positions of such suspended member shall be closed out pursuant to the rules of the Options Clearing Corporation.

Section 11 establishes the exercise cut-off time with respect to the tendering of an exercise notice for an outstanding option contract. Subsection (a) provides that an outstanding option contract, subject to and in accordance with certain rules of the Association and the Options Clearing Corporation, may be exercised by the holder of the option contract only through the clearing member carrying the option contract of the holder. Subsection (a) further provides that the Association shall establish the cut-off time on the business day immediately prior to the expiration date for the given series of options.

Subsection (b) would authorize four exceptions with respect to the tendering of an exercise notice after the established cut-off time but prior to the expiration of the option contract. These exceptions are self-explanatory.

Subsection (c) provides that a member shall establish fixed procedures relative to the assigning of exercise notices to short option positions maintained in the accounts of customers. The method of allocation shall be determined by the member. However, any method selected by the member must provide for fair and equitable treatment of the member's customers. Several methods of allocation are set forth and all are self-explanatory. Subsection (c) further provides that in the event of an exercise notice of 25 or more units of trading (which would be considered "block size"), the member may allocate such notice to a customer having an open short position of block size and, that in the event of an exercise notice of less than block size, the member may allocate such notice to the extent possible to a customer having a short position of less than block size. A member would be required to file its proposed allocation method for the assignment of exercise notices with the Association and obtain Association approval prior to its implementation. Any changes by the member to an approved allocation method would also be required to be reported to and approved by the Association prior to implementation. Furthermore, a description of the allocation method would be required to be furnished, upon request, to customers.

Subsection (d) specifically provides that the rules of the Options Clearing Corporation shall prevail as the procedures for the settlement of exercised contracts. Those procedures are applicable to both the delivery of the shares of the underlying security and the payment of the aggregate exercise price. The member would be required to have the customer make prompt full cash payment of the aggregate exercise price or to promptly deposit the shares of the underlying security, if such shares are not carried in the account of the customer, or to promptly deposit the required margin deposit in the event the exercise was tendered against a margin account.

Subsection (e) requires a report to be filed with the Association by each member as of the 10th of each month indicating all open positions resulting from the exercise of option contracts in accounts carried by that member.

Section 12 would specify that the provisions of Parts IV and IX of Schedule D would, to the extent not inconsistent with the provisions of Part X, apply to NASDAQ options.

Proposed Amendments to Schedule C
of the By-Laws

It should be noted that the proposed amendments to Schedule C are to a proposed new Schedule C which was previously submitted to the membership for comment and, subsequently, with modifications, approved by the Board of Governors and filed for approval with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended on November 20, 1975. The SEC has not yet acted on that filing.

New Section 4 of Part I would require any member engaged in put or call options activities, whether for the account of a public customer or for the account of the firm, to have a person associated with such member registered with the Association as a "Registered Options Principal." Section 4 would also require that all persons who are actively engaged in the management, direction or supervision of the day-to-day options activities of any member shall be registered as Registered Options Principals. It should be noted that this provision would not be restricted to members engaging only in NASDAQ options activities. It is designed to embrace firms and persons engaging in conventional or traditional over-the-counter option transactions and non-exchange firms (access firms) engaging in exchange listed option transactions through exchange members.

New Section 2(f) of Part II would require that as a condition to becoming a Registered Options Principal, a person associated with a member must pass an appropriate qualification examination for registered options principals, or an equivalent acceptable to the Association. The latter provision would give the Association the authority to determine whether an examination given by one or the other of the options exchanges would be acceptable for purposes of qualifying as a Registered Options Principal with the Association. In this connection, the Board has determined that the Registered Options Principals already admitted to the various exchanges will be exempted from the Association's options principal examination. New Section 2(f) would also specify that a person shall not qualify as a Registered Options Principal for both put and call options unless he has passed an examination testing him with respect to both put and call options. This is consistent with exchange requirements.

The proposed amendments to Schedule C are consistent with the entry standard programs undertaken by the Association in recent years. These programs are aimed at insuring that a member has competent and experienced persons engaged in the management of specialized areas of activity, such as options trading. Accordingly, the Association believes the Registered Options Principal requirement is necessary and appropriate for an open and orderly market and in the best interest of investors and the public.

Proposed Amendments to Article III, Section 30 of
the Rules of Fair Practice

It should be noted that the proposed amendment to Appendix A of Section 30 of the Rules of Fair Practice is to the designated section as it has already been amended by the Board and filed with the SEC on October 14, 1975, for its approval. The SEC has not acted on that filing as yet.

The proposed amendment to Section 4(a)(4)(ii) of Appendix A, Section 30, would conform the NASD's margin requirements to those presently applicable to exchange traded options. Specifically, the proposed amendment would provide that the margin maintenance rate with respect to an uncovered short position in a NASDAQ option be 30 percent of the market value of the equivalent number of shares of the underlying security. Presently, this provision provides for a 50 percent minimum margin maintenance requirement for all put and call options.

By conforming the Association's rule to those of the options exchanges, uniform margin maintenance requirements as to all option contracts issued by the Options Clearing Corporation would be in place. It should be noted, however, that this proposed amendment does not change the effective margin maintenance rate presently applied to a conventional or traditional over-the-counter option which will remain at present levels.

Appendix E

NASDAQ Options Rules

Changes are from the proposals contained in Notice to Members No. 76-8.
New Material is Indicated by Underlining
Deleted Material is Indicated by Striking Out

Section 1 - General

(a) Applicability - The Rules in this Appendix E shall be applicable (1) to the trading of ~~NASDAQ~~ option contracts issued by the Options Clearing Corporation and displayed on the NASDAQ system, the terms and conditions of such contracts and the exercise and settlement thereof; (2) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange listed options by members who are not members of the exchange on which the option executed is listed; and (3) to the conduct of accounts, the execution of transactions, and the handling of orders in options not covered by the provisions of subparagraphs (1) and (2) hereof and (4) other matters related to options trading.

(b) Except to the extent that specific sections in this Appendix govern, or unless the context otherwise requires, the provisions of the By-Laws and Rules of Fair Practice and all other interpretations and policies of the Board of Governors shall also be applicable to the trading of option contracts. ~~displayed on NASDAQ.~~

(c) ~~(b)~~ Local Time - All times are stated in these Rules in terms of the local time in effect in New York City (Eastern Standard Time) or as otherwise specified.

Section 2 - Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

(a) Options Clearing Corporation - The term "Options Clearing Corporation" means the Options Clearing Corporation, the issuer of options displayed on NASDAQ.

(b) Rules of the Options Clearing Corporation - The term "rules of the Options Clearing Corporation" means the by-laws and the rules of the Options Clearing Corporation, and all written interpretations thereof as may be in effect from time to time.

(c) Clearing Member - The term "clearing member" means a member of the Corporation which has been admitted to membership in the Options Clearing Corporation pursuant to the provisions of the rules of the Options Clearing Corporation.

(d) Participant Organization - The term "participant organization" means a registered national securities exchange or a registered national securities association which has qualified for participation in the Options Clearing Corporation pursuant to the provisions of Article VII of the By-Laws of the Options Clearing Corporation.

(e) Option Contract - The term "option contract" means ~~a put or a call issued, or subject to issuance, by the Options Clearing Corporation pursuant to the rules of the Options Clearing Corporation.~~ any put, call, straddle or other option or privilege of buying a security from or selling a security to another without being bound to do so, but shall not include any tender offer, registered warrant, right, convertible security or any other option in respect to which the writer is the issuer of the security which may be purchased or sold upon the exercise of the option.

(f) Option Transaction - The term "option transaction" means a transaction effected by a member for the purchase or sale of an option contract, or for the closing out of a long or short position in such option contract.

(g) NASDAQ Option Transaction - The term "NASDAQ option transaction" means a transaction effected by a member in an option or options displayed on NASDAQ for the purchase or sale of an option contract which is the subject of quotation on the NASDAQ System or for the closing out of a long or short position in such option contract.

(h)(g) Type of Option - The term "type of option" means the classification of an option contract as either a put or a call.

(i)(h) Call - The term "call" means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase ~~from the Options Clearing Corporation~~ the number of shares of the underlying ~~stock~~ security covered by the option contract. In the case of a "call" issued by the Options Clearing Corporation, it shall mean an option contract under which the holder of the option has the right, in accordance with the terms of the option, to purchase from the Options Clearing Corporation the number of shares of the underlying security covered by the option contract.

(j)(i) Put - The term "put" means an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell ~~to the Options Clearing Corporation~~ the number of shares of the underlying ~~stock~~ security covered by the option contract. In the case of a

"put" issued by the Options Clearing Corporation, it shall mean an option contract under which the holder of the option has the right, in accordance with the terms of the option, to sell to the Options Clearing Corporation the number of shares of the underlying security covered by the option contract.

(k)(j) Class of Options - The term "class of options" means all option contracts of the same type of option covering the same underlying ~~stock~~ security.

(l)(k) Series of Options - The term "series of options" means all option contracts of the same class of options having the same ~~expiration-date~~ and exercise price, expiration date and unit of trading.

(m)(l) Group of Options - The term "group of options" means all option contracts of the same class of options having the same exercise price and unit of trading but separate expiration dates.

(n)(l) Underlying Security - The term "underlying security" in respect of an option contract means the security which the Options Clearing Corporation or another person shall be obligated to sell (in the case of a call) or purchase (in the case of a put) upon the valid exercise of such option contract.

(o)(m) Exercise Price - The term "exercise price" in respect of an option contract means the stated price per share at which the underlying ~~stock~~ security may be purchased (in the case of a call) or sold (in the case of a put) upon the exercise of such option contract.

(p)(n) Aggregate Exercise Price - The term "aggregate exercise price" means the exercise price of an option contract multiplied by the number of shares of the underlying ~~stock~~ security covered by such option contract.

(q)(o) Expiration Month - The term "expiration month" in respect of an option contract means the month and year in which such option contract expires.

(r)(p) Expiration Date - The term "expiration date" ~~in respect of~~ an option contract issued by the Options Clearing Corporation means the Saturday immediately following the third Friday of the expiration month of such option contract. The term "expiration date" of all other option contracts means the date specified thereon for such.

(s)(q) Long Position - The term "long position" means the number of outstanding option contracts of a given series of options held by a person (purchaser).

(t)(r) Short Position - The term "short position" means the number of outstanding option contracts of a given series of options with respect to which a person is obligated as a writer (seller).

(u)(s) Opening Purchase Transaction - The term "opening purchase transaction" means a ~~NASDAQ~~ an option transaction in which the purchaser's intention is to create or increase a long position in the series of options involved in such transaction.

(v)(t) Opening Writing Transaction - The term "opening writing transaction" means a ~~NASDAQ~~ an option transaction in which the seller's (writer's) intention is to create or increase a short position in the series of options involved in such transaction.

(w)(u) Closing Sale Transaction - The term "closing sale transaction" means a ~~NASDAQ~~ an option transaction in which the seller's intention is to reduce or eliminate a long position in the series of options involved in such transaction.

(x)(v) Closing Purchase Transaction - The term "closing purchase transaction" means a ~~NASDAQ~~ an option transaction in which the purchaser's intention is to reduce or eliminate a short position in the series of options involved in such transaction.

(y)(w) Covered - The term "covered" in respect to a short position in an option contract means that the writer's obligation is secured by a "bulk deposit" or "specific deposit" evidenced by an "escrow receipt" of underlying security, or the writer holds an equivalent long position in the underlying security in an account with a member of the Corporation through whom the option contract was written.

(z)(x) Uncovered - The term "uncovered" in respect of a short position in an option contract means the short position is not covered.

(aa)(y) Outstanding - The term "outstanding" in respect of an option contract means an option contract which ~~has been issued by the Options-Clearing Corporation and~~ has neither been the subject of a closing sale transaction or a comparable closing transaction nor has been exercised nor reached its expiration date. The term "outstanding" is sometimes used synonymously with the term "open interest."

~~(z) - Primary Market - - The term "primary market" as used herein means the principal market(s) in which an option or an underlying security is traded.~~

(bb)(aa) Registered NASDAQ Options Market Maker - The term "registered NASDAQ options market maker" means a member who meets the qualifications for such set forth in Section 3, Schedule D to Article XVI of the By-Laws, is willing and able to serve as such in connection with a NASDAQ option contracts on an authorized underlying security and who is authorized by the Corporation to do so.

(cc)(bb) Member - The term "member" means any member of the Corporation.

~~(dd)(cc)~~ Options Trading - The term "options trading" when not preceded by the word NASDAQ, means trading (1) in any option issued by the Options Clearing Corporation, whether or not of a class, group or series which has been approved for listing on NASDAQ; and (2) in any other option contract.

~~(ee)(dd)~~ Premium - The term "premium" means the aggregate price of an option agreed upon between the buyer and writer/seller or their agents.

~~(ff)(ee)~~ Escrow Receipt - The term "escrow receipt" means a representation by an issuing bank to the Options Clearing Corporation that a particular customer's securities are on deposit with the bank and will be delivered upon exercise of the option for which the receipt is issued.

~~(gg)(ff)~~ Current Prospectus - The term "current prospectus" shall mean that edition of the prospectus of the Options Clearing Corporation issued by the Options Clearing Corporation as registrant with the Securities and Exchange Commission which at the time it is to be furnished to a given customer meets the requirements of Section 10(a)(3) of the Securities Act of 1933.

~~(hh)(gg)~~ Spread Order - The term "spread order" means an order to buy a particular option contract and to sell another option contract.

~~(ii)(hh)~~ Dual Market Maker - The term "dual market maker" means a registered NASDAQ options market maker who makes a market in the underlying security of an option displayed on the NASDAQ System while simultaneously making a market in the option itself; provided, however, that the provisions of Schedule D, Section 2(e), Part X, have been satisfied.

~~(jj)~~ Conventional Option - The term "conventional option" shall mean any option not issued, or subject to issuance, by the Options Clearing Corporation.

Section 3 - Position Limits

(a) Except with the prior written approval of the Corporation or as provided in subsection (b) hereof, no member shall effect for any account in which such member has an interest, including investment and trading accounts of a registered NASDAQ options market maker, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, an opening transaction in any class of options issued by the Options Clearing Corporation if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or cus-

holder, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of:

- ~~(1) an aggregate long position in any class of options;~~
- ~~(2) an aggregate long position in any expiration month in any class of options;~~
- ~~(3) an aggregate short position in any class of options;~~
- ~~(4) an aggregate short position in any expiration month in any class of options; or~~
- ~~(5) an aggregate uncovered short position in any class of options;~~

~~in excess of such number of option contracts as shall be fixed from time to time by the Corporation as the position limit for that particular class of options or expiration month. Such limits, as modified from time to time by action of the Corporation, shall be contained in Schedule -- hereof.~~

an aggregate position (whether long or short) in excess of either:

- (1) 1,000 option contracts of the same class of options;
- (2) 500 option contracts of the same class and the same expiration date (provided, however, that the limit imposed by this paragraph (2) shall not be applicable either (i) to covered short positions or (ii) to short positions to the extent long positions for the same number of option contracts of the same class of options are maintained in the same account where the exercise prices of the option contracts in such long positions are equal to or less than the exercise prices of the option contracts in such short positions); or
- (3) such other number of option contracts as may be fixed from time to time by the Corporation as the position limit for one or more classes or series of options. Reasonable notice shall be given of each new position limit fixed by the Corporation.

~~(b) Nothing in subsection (a) hereof shall be construed so as to limit the ability of a registered NASDAQ options market maker to maintain a fair, orderly and continuous market in a class or series of NASDAQ options for which such market maker is registered with the Corporation.~~

(b) Except with the prior written approval of the Corporation, no member who is a dual market maker shall effect for its trading account, an opening transaction in any series of option contracts if the member has reason to believe that as a result of such transaction it would hold or control, or be obligated in respect of, an aggregate position (whether long or short) in any series of options, or an aggregate uncovered short position in any series of options in excess of ___ percent of the outstanding option (open interest) contracts for that series reported as of the previous day.

Section 4 - Exercise Limits

(a) Except with the prior approval of the Corporation in each instance, no member shall exercise, for any account in which such member has an interest including investment and trading accounts of a registered NASDAQ options market maker or for the account of any partner, officer, director or employee thereof or for the account of any customer, a long position in any option contract ~~issued by the Options Clearing Corporation~~ if as a result thereof such member or partner, officer, director or employee thereof or customer, acting alone or in concert with others, directly or indirectly, has or will have exercised within any five (5) consecutive business days aggregate long positions in a class of options in excess of ~~such number of 1,000 option contracts as shall be fixed from time to time by the Corporation as the exercise limit for that particular class of options, or such other~~ The number of and time limitations concerning the exercise of option contracts as modified may be fixed from time to time by action of the Corporation. shall be contained in Schedule --- hereof. Reasonable notice shall be given of each new number and time limitation fixed by the Corporation.

~~(b) Nothing in subsection (a) hereof shall be construed to limit the ability of a registered NASDAQ options market maker to maintain fair, orderly and continuous market in a class or series of NASDAQ options for which such market maker is registered with the Corporation.~~

Section 5 - Reporting of Options Positions

(a) Each member shall file with the Corporation a report with respect to each account in which the member has an interest, including investment accounts of a registered NASDAQ options market maker, each account of a partner, officer, director, or employee of such member, and each customer account, which has (1) an aggregate long position, or (2) an aggregate short position, or (3) an aggregate uncovered short position, of 100 or more option contracts of any class of options, ~~issued by the Options-~~

~~Clearing Corporation in excess of such number of as shall be fixed from time to time by the Corporation as requiring reporting pursuant to this Section. - The said requirements shall be contained in Schedule -- attached hereto.~~

Such report shall identify the person or persons having an interest in such account and shall identify separately the total number of option contracts of each such class comprising the long position, short position and uncovered short position, in such account. The report shall be in such form as may be prescribed by the Corporation and shall be filed no later than the close of business on the next business day following the day on which the transaction or transactions requiring the filing of such report occurred. Whenever a report shall be required to be filed with respect to an account pursuant to this subsection, the member filing such shall file with the Corporation such additional periodic reports with respect to such account as the Corporation may from time to time prescribe.

(b) In addition to the reports required by subsection (a) of this Section, each member shall report promptly to the Corporation any instance in which such member has knowledge that a person, acting alone or in concert with others, has exceeded or is attempting to exceed the position limits or the exercise limits set forth in Sections 3 and 4 hereof. ~~Schedule -- attached hereto.~~

(c) Every member who has an uncovered short position in any class of options ~~issued by Options Clearing Corporation~~ shall file with the Corporation a report reflecting such in:

- (1) each account in which the member has an interest, including investment accounts of a registered NASDAQ options market maker;
- (2) all accounts of partners, principal executive officers and directors of such member; and
- (3) all accounts of customers.

Such report shall be made as of the 10th of each month (or more frequently if required by the Corporation) and shall be submitted not later than the second business day following the date as of which the report is made.

(d) Every member who has been notified by the Corporation that he is subject to the provisions of this Section or who shall effect ~~NASDAQ~~ option transactions for its account amounting to five or more option contracts of the same class during any trading session shall report such transactions to the Corporation on a basis and frequency to be established for such member by the Corporation. Such report shall be on a form prescribed by the Corporation.

(e) The provision of subsection (d) shall not apply to the trading accounts of registered NASDAQ options market makers.

(f) In addition to the reporting provisions set forth in subsections (a) through (d) hereof, a member who is a dual market maker shall be required to file information with the Corporation in respect to transactions and positions relative to conventional options on underlying securities subject to options displayed on NASDAQ. Such information shall be filed at a time and in a manner as prescribed by the Corporation.

Section ~~9~~ 6 - Liquidation of Position

(a) Whenever the Corporation shall determine that a person or a group of persons acting in concert holds or controls, or is obligated in respect of, an aggregate position (whether long or short) in all option contracts ~~issued by the Options Clearing Corporation~~ of one or more classes or series of options displayed on NASDAQ in excess of the applicable position limit established pursuant to Section 3 hereof ~~and contained in Schedule --- appended hereto~~ and where the Corporation determines that the maintenance of such excess position is inconsistent with the public interest and endangers investor safety and the maintenance of a fair and orderly market:

- (1) the Corporation may, in the case of a member found to hold such excess position, orally notify, confirmed by a written notice to the member, advising the member that it holds a position in options which exceeds the limits established pursuant to Section 3 hereof. Said oral and written notices shall also advise the member that, within seven (7) calendar days of the date of oral notification the member shall reduce his position to the extent necessary to eliminate the excess position in a manner consistent with these rules. The notice shall further advise the member to communicate to the Corporation within five (5) calendar days his intentions with regard to the elimination of the excess position and to thereafter report to the Corporation when the said reduction of excess position has been accomplished; and
- (2) the Corporation may in the case of any other person, including a public customer, found to hold such excess position, direct that the member or members with whom such person or persons has an options account, to orally notify, confirmed by a written notice sent on a form to be prescribed by the Corporation to, such person or persons advising such person or persons that the Corporation has determined that an excess position in violation of the limits established pursuant to Section 3 exists in the account of

such person or persons and further advising such person or persons that within seven (7) calendar days of the issuance of the notice by the member, the person or persons holding the excess position shall reduce their aggregate option positions in a manner consistent with these rules to the extent necessary to eliminate the excess position. The notice shall also advise such person or persons to communicate to the member or members with whom such person or persons have an options account and to the Corporation his or their intentions with regard to the elimination of the excess position.

(b) The Corporation may, in either instance, where it determines that such is necessary in the public interest and necessary for the protection of investors and the maintenance of a fair and orderly market, direct a notice, oral or written, to members advising the members of any person or persons determined to hold a position in options which exceeds the position limits established pursuant to Section 3 hereof. Upon the issuance of such notice any order for the account of the person or persons named in such directive which would have the effect of increasing the excess position of said person shall not be accepted unless in each instance expressed approval for such transaction is given by the Corporation or until such directive is rescinded.

Section 10 7 - Limit on Uncovered Short Positions

Whenever the Corporation shall determine in light of current conditions in the markets for options, ~~issued by the Options Clearing Corporation displayed on NASDAQ,~~ or in the markets for underlying securities, that there are outstanding a number of uncovered short positions in NASDAQ option contracts of a given class ~~displayed on NASDAQ,~~ in excess of the limits established by the Corporation for purposes of this section ~~and contained in Schedule --- appended hereto,~~ or that a percentage of outstanding short positions in NASDAQ option contracts of a given class ~~displayed on NASDAQ~~ are uncovered, in excess of the limits established by the Corporation for purposes of this section, ~~and contained in Schedule --- appended hereto,~~ the Corporation, upon its determination that such action is in the public interest and necessary for the protection of investors and the maintenance of a fair and orderly market in the option contracts or underlying securities, may prohibit any further opening writing transactions in option contracts of that class unless the resulting short position will be covered, and it may prohibit the uncovering of any existing covered short position in option contracts of one or more series of options of that class. The Corporation may exempt transactions of registered NASDAQ options market makers from restrictions imposed under this Section and it shall rescind such restrictions upon its determination that they are no longer appropriate.

Section 11 8 - Restrictions on NASDAQ Option Transactions and Exercises

(a) Subject to the provisions of subsections (b) and (c) hereof, no member shall enter on behalf of a customer, on behalf of any officer, director, principal, employee or affiliate of the member, or on behalf of the investment account of the member, any order for an opening transaction in any call option contract ~~issued by the Options Clearing Corporation and displayed on NASDAQ if the exercise price of such option exceeds such dollar amount as shall from time to time be established by the Corporation for purposes of this section and contained in Schedule --- appended hereto; and, the closing price of the underlying security for such call option on the last prior day in the principal market(s) in which such underlying security was traded, is less than such dollar amount as shall from time to time be fixed by the Corporation for purposes of this section and contained in Schedule --- appended hereto.~~ if (1) the exercise price is more than \$5.00 above the representative bid of the underlying security for such call option on the last previous day in which such underlying security was traded; and (2) the representative bid of such call option was less than \$.50 per unit of trading on the last previous day on which the call option was traded.

(b) The restrictions set forth in subsection (a) hereof shall not apply to:

- (1) The entry of an order for any opening writing transaction that is covered in the account on a share-for-share basis by a long position in either the underlying security or a security immediately exchangeable or convertible without restriction, other than the payment of money, into the underlying security; or
- (2) The entry of a spread order for the purchase and sale of the same number of option contracts of the same class.

(c) The Corporation may (1) interpret or modify any of the foregoing provisions with respect to particular orders and transactions, and (2) make exceptions, modifications or additions to any of the foregoing provisions with respect to one or more series of options whenever the Corporation determines that such exceptions, modifications, or additions are necessary in the interest of maintaining a fair and orderly market in option contracts or in underlying securities or otherwise are necessary in the public interest or for the protection of investors; provided, however, that any such exception, modification or addition pursuant to paragraph (2) hereof shall become effective not earlier than 15 minutes after it is displayed on NASDAQ and shall not remain in effect for more than two (2) business days unless ratified by a committee of the Board of Governors authorized by it to do so; and provided further that all action taken under this subsection (c) and the reasons therefor shall be reported in writing to the said committee of the Board not later than the business day immediately following the one on which such action is taken.

(d) The Corporation may impose from time to time such restrictions on option transactions or the exercise of option contracts in one or more series of options of any class ~~issued by the Options Clearing Corporation displayed on NASDAQ~~ which it determines are necessary in the interest of maintaining a fair and orderly market in option contracts, or in the underlying securities covered by such option contracts, or otherwise necessary in the public interest or for the protection of investors. During the period of any such restriction, no member shall effect any option transaction or exercise any option contract ~~issued by the Options Clearing Corporation displayed on NASDAQ~~ in contravention of such restriction. Notwithstanding the foregoing, during the ten (10) business days prior to the expiration date of a given series of options, no restriction on the exercise of option contracts shall remain in effect with respect to that series of options.

Section-~~6~~- 9 - Confirmations

Every member shall promptly furnish to each customer a written confirmation of each transaction in option contracts for such customer's account. Each such confirmation shall show the type of option, the underlying security, the expiration month, the exercise price, the number of option contracts, the premium, the commission, the trade and settlement dates, whether the transaction was a purchase or a sale (writing) transaction, whether the transaction was an opening or a closing transaction, and whether the transaction was effected on a principal or agency basis. The confirmation shall by appropriate symbols distinguish between NASDAQ option transactions and other transactions in option contracts. A member effecting a transaction in option contracts for a customer's account while acting as a market maker in both the option and its underlying security shall also disclose such information to the customer on the confirmation.

Section-~~7~~- 10 - Delivery of Current Prospectus

Every member shall deliver a current prospectus to each customer at or prior to the time such customer's account is approved for ~~options~~ trading of options issued by the Options Clearing Corporation. Thereafter, each new current prospectus shall be distributed to every customer having an account approved for ~~options~~ such trading or in the alternative, shall be forwarded not later than the time a trade is entered or accepted on the behalf of the customer.

Section ~~8~~ 11 - Transactions with Issuers

No member under any circumstances shall enter a transaction for an option contract for the account of any corporation which is the issuer of the underlying security thereof, or for the account of any person, corporation, partnership or other entity which controls, or is controlled by or under common control with such corporation; or for a partner or joint venturer or other affiliate of such corporation.

Section ~~9~~ 12 - Restricted Stock

Shares of an underlying security which may not be sold by the holder thereof except upon registration thereof pursuant to the provisions of the Securities Act of 1933 or pursuant to SEC rules promulgated under the Securities Act of 1933, may not be accepted by a member for the purpose of covering a short position in option contracts or satisfying the margin requirements in respect thereto, and may not be delivered for the purpose of satisfying an exercise notice assigned in respect of any such option contract.

Section ~~10~~ 13 - Statements of Accounts

Statements of account shall be sent no less frequently than once every month to each customer in whose account there has been an entry during the preceding month with respect to an option contract and quarterly to all customers having an open option position and money balance.

Section ~~11~~ 14 - Opening of Accounts

(a) Approval Required - No member or person associated with a member shall accept an order from a customer for the purchase or writing (sale) of an option contract unless the customer's account has been approved for options trading in accordance with the provisions of subsections (b) and (c) hereof.

(b) Diligence in Opening Account - Before approving a customer's account for options trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential facts relative to the financial situation and investment objectives of such customer. Based upon such facts, the member or a general partner or officer of the member who is a Registered Options Principal and who is personally informed of such essential facts shall specifically approve in writing the customer's account for options trading prior to the time any option transaction is entered on behalf of such

customer by the member or the person associated with the member; provided, however, that in the case of a branch office, an account may be approved for options trading by the manager of such branch office, in which event the action of such branch office manager shall within seven (7) business days be submitted to and approved by a Registered Options Principal. A record of the information obtained pursuant to this Section and of the approval of each such account shall be maintained by the member as part of its permanent records.

(c) Account Agreement - No customer's account shall be approved for options transactions by a member unless it first obtains Within 15 calendar days after a customer's account has been approved for option transactions, a member shall obtain from the customer a written agreement that the customer is aware of and agrees to be bound by the rules of the Corporation applicable to the trading of option contracts and, if he desires to engage in transactions in options issued by the Options Clearing Corporation, the rules of the Options Clearing Corporation.

Section 12-15 - Discretionary Accounts

(a) Authorization and Approval - No member and no partner, officer or employee of a member shall exercise any discretionary power with respect to trading in option contracts in a customer's account, or accept orders for option contracts for an account from a person other than the customer, except in compliance with the provisions of Section 15 of the Rules of Fair Practice and unless:

- (1) the written authorization of the customer required by Section 15 shall specifically authorize options trading in the account;
- (2) the account shall have been accepted by a general partner or officer of the member who is a Registered Options Principal; and
- (3) the person approving all ~~such orders with respect to~~ NASDAQ option transactions in such account shall be a Registered Options Principal;

provided, however, that in the case of a branch office, discretionary orders may be approved and initialed on the day entered by the branch office manager, provided that such approval shall be subsequently approved within five (5) business days by a general partner or officer of the member who is a Registered Options Principal. The provisions of this subsection shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of option contracts shall be executed.

(b) Record of Transactions - A record shall be made of every transaction in option contracts in respect to which a member or a partner, officer or employee of a member has exercised discretionary authority, clearly reflecting such fact and indicating the name of the customer, the designation and number of the option contracts, the premium and the date and time when such transaction was effected.

Section 13 16 - Suitability

(a) No member or person associated with a member shall recommend to any customer any transaction for the purchase or writing (sale) of an option contract unless such member or person associated therewith has reasonable grounds to believe upon the basis of information furnished by such customer after reasonable inquiry by the member or person associated therewith concerning the customer's investment objectives, financial situation and needs, and any other information known by such member or associated person that the recommended transaction is not unsuitable for such customer.

(b) No member or person associated therewith shall effect with or for any customer any transaction whereby such customer writes, or after writing, is obligated as a writer with respect to:

- (1) a call option contract with respect to an underlying security which is not long in the customer's account with the member or which, at the time of writing, is not concurrently purchased by such customer for such account; provided, however, an account shall be deemed long an underlying security if it is long in a security immediately exchangeable or convertible, without restriction other than the payment of money, into such underlying security; or
- (2) a put option contract with respect to an underlying security in which the customer has a short position or, at the time of writing, has effected concurrently a short sale of the underlying security to which such option contract relates;

unless on the basis of information obtained by such member or registered employee from such customer, after reasonable and diligent inquiry, and any other information known by such member or registered employee, such member or registered employee has a reasonable basis for believing that the customer, at the time of the transaction, is capable of evaluating the additional risks in such transactions, and has the financial capability to meet reasonably foreseeable margin calls pursuant to applicable margin requirements with respect to the proposed position in such call option contract or put option contract and the related short position in the underlying security.

Section ~~14~~ 17 - Supervision of Accounts

Every member shall provide for the diligent supervision by a general partner or officer of the member who is a Registered Options Principal of all of its customer accounts, and all orders in such accounts, to the extent such accounts and orders relate to option contracts.

Section ~~15~~ 18 - Violation of By-Laws and Rules of the Options Clearing Corporation

Any violation of any provision of the rules, regulations or by-laws of the Options Clearing Corporation by any member or person associated with a member engaged in ~~NASDAQ option~~ transactions involving options issued, or subject to issuance, by the Options Clearing Corporation, may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of Article III, Section 1 of the Corporation's Rules of Fair Practice.

Section ~~16~~ 19 - Rules of General Applicability

The provisions of Article III, Sections ~~1 2,-3,-4,-5~~ through 6, 10 11,-12 through 13, 15, 18 19,-20, through 21, 23 through 25, 27, 28, and 30 of the Rules of Fair Practice are applicable to option transactions. Unless the context otherwise requires, the terms "security" or "securities" whenever used herein shall also mean ~~NASDAQ~~ options.

SCHEDULE D

PROPOSED PART X

PROPOSED
NASDAQ SYSTEM RULES AND REGULATIONS
FOR NASDAQ OPTIONS

Section 1 - Definitions

~~(a) The term "registered NASDAQ options market maker" means a member who meets the qualifications for such set forth in Section 3 hereof, is willing and able to serve as such in connection with a NASDAQ option on an authorized underlying security and who is authorized by the Corporation to do so.~~

(a)(b) The term "authorized underlying security" means a security which is eligible to be subject to a NASDAQ option pursuant to the provisions of Section 6 hereof and which has been designated by the Corporation to be an authorized underlying security.

(b) The term "NASDAQ option contract" means an option, issued or subject to issuance by the Options Clearing Corporation, that is eligible for quotation display on the NASDAQ System.

(c) The term "unit of trading" means the number of units of the underlying security designated by the Options Clearing Corporation as the subject of a single option contract. In the absence of any other designation, the unit of trading for a common stock is 100 shares.

(d) Unless the context otherwise requires, or unless defined herein, the terms used in this Part X of this Schedule shall have the meanings as defined in Section 2 of Appendix E to Article III, Section 33 of the Rules of Fair Practice.

Section 2 - Services Available

(a) Level 1 Service

(1) Nature of Service This service will provide the subscriber with data in the form of representative bid and ask quotations for each NASDAQ option on which a minimum of two registered NASDAQ options market makers are entering quotes during the day.

(2) Availability The service is available only through independent firms authorized by the Corporation to obtain access to the data from the NASDAQ System for distribution to others. The subscriber must agree with the Corporation that the quotations data received through such service will not be used for illegal purposes nor will access thereto be granted on a continuous basis to any person not approved by the Corporation, and the independent distributor must obtain authorization in writing from the Corporation to serve the subscriber.

(b) Level 2 Service

(1) Nature of Service This service will provide the subscriber with access to the quotations of all of the registered NASDAQ options market makers entering quotes on each of the NASDAQ options.

(2) Availability The service is available only to persons approved by the Corporation.

(c) Level 3 Service

(1) Nature of Service This service will enable the registered NASDAQ options market maker to enter quotations into the System only on the NASDAQ options as to which the Corporation has authorized it to enter quotes. Subscribers to Level 3 service shall also receive Level 2 service.

(2) Availability Level 3 service is available to any member which, upon application, is authorized by the Corporation to participate in the NASDAQ System as a registered NASDAQ options market maker.

Section 3 - Registration, Qualification and Other Requirements of Market Makers and Others

(a) Prior to acting as a market maker in NASDAQ options, a member must make application to the Corporation and become registered as such with it. In connection with such application, a member must submit to the Corporation such financial and other information determined as required by the Corporation ~~to be necessary~~ to determine if it such member meets the qualifications of a registered NASDAQ options market maker specified hereafter.

(b) Financial Capability A registered NASDAQ options market maker shall continually maintain a net capital of ~~\$100,000~~ computed at least \$50,000 computed in accordance with the provisions of Paragraph (c)(2) of Rule 15c3-1 under the Securities Exchange Act of 1934, as amended, plus \$5,000 per options series up to a maximum requirement of \$150,000.

(c) A registered NASDAQ options market maker shall either be a clearing member of the Options Clearing Corporation or shall have established a clearing arrangement with a clearing member thereof.

(d) A registered NASDAQ options market maker shall have a Registered Options Principal as required by the provisions of Section 2(d) of Schedule C of Article I of the By-Laws.

(e) A member shall not become a dual market maker in a NASDAQ option and its underlying security unless the NASDAQ option group in respect to which a dual market is intended to be made and its underlying security each have a minimum of five market makers.

(f)(e) Character of quotations entered into the System

(1) All bids or offers for ~~option contracts issued by the Options Clearing Corporation displayed on NASDAQ~~ NASDAQ options shall be for at least one option contract for the minimum unit of trading.

(2) All bids or offers for NASDAQ options ~~contracts issued by the Options Clearing Corporation displayed on NASDAQ~~ shall be expressed in terms of dollars per share of the underlying security; provided, however, all such bids or offers for a NASDAQ option contract for which the Options Clearing Corporation has established an adjusted unit of trading in accordance with paragraphs (c) and (d) of Section 11 of Article VI of the By-Laws of the Options Clearing Corporation shall be expressed in terms of dollars per the appropriate fractional part of the total securities and/or other property constituting such adjusted unit of trading.

(3) A registered NASDAQ options market maker which receives a buy or sell order must execute a trade for at least one NASDAQ option contract at his quotations as displayed on NASDAQ at the time of receipt of any such buy or sell order. Each quotation entered and displayed by a registered NASDAQ options market maker shall be reasonably related to the then prevailing market.

(g)(f) Transaction Reporting

(1) Real Time

~~a. A registered NASDAQ options market maker shall transmit to the Corporation last sale reports of all purchases and writing (sales) transaction in NASDAQ options executed during the normal trading hours within one and one-half minutes after execution of the transaction. Such report shall hereinafter be referred to as Last Sale Report and shall be on a form prescribed by the Corporation. All Last Sale Reports of purchase and writing (sale) transactions executed during the normal trading hours shall be transmitted through the NASDAQ Transaction Reporting System. Last Sale Reports of purchase and writing (sale) transactions executed outside of normal trading hours shall be reported weekly in writing to the NASDAQ supervisory office in New York City.~~

a. Every member shall transmit to the Association reports of writing (sale) transactions in NASDAQ options executed during the trading hours of the Options Price Reporting Authority (OPRA), within one and one-half minutes after execution of the transaction. The trading hours of OPRA are currently 10:00 a.m. to 4:00 p.m. Eastern Time. If such report is not transmitted within one and one-half minutes after execution, such report shall be designated as late. All reports of transactions executed during the trading hours of OPRA shall be transmitted through the NASDAQ System. Last sale reports of transactions executed outside of OPRA's trading hours shall be reported weekly in writing to the NASDAQ supervisory office in New York City.

b. ~~A registered-NASDAQ options market maker member~~ shall transmit a Last Sale Report report for NASDAQ options for ~~all purchases~~ and writing (sales) transactions in such options at the price recorded on the trade ticket exclusive of commissions, taxes or other charges.

~~c. In transactions between two registered-NASDAQ options market makers, only the registered-NASDAQ options market maker representing the writing (sell) side shall make a Last Sale Report.~~

d. ~~c. A registered-NASDAQ options market maker member~~ shall not transmit to NASDAQ a Last Sale Report report for transactions executed on an exchange.

(2) Weekly and/or Monthly ~~A registered-NASDAQ options market maker member~~ shall report weekly and/or monthly to the System such data on NASDAQ options quoted in the System as the Board of Governors shall require. Such report shall be on a form prescribed by the Corporation.

(3) All trade tickets on transactions in NASDAQ options must be time-stamped at the time of execution.

(h)(g) Normal Business Hours A registered NASDAQ options market maker shall keep the Corporation advised as to the normal business hours (Eastern Time) during which it shall enter quotations. All firms shall be open and active as of 10:00 a.m. Eastern Time and no registered NASDAQ options market maker shall close sooner than 4:00 p.m. Eastern Time. However, the registered NASDAQ options market maker will be able to enter quotes outside such normal business hours, provided the System is operating, by appropriate notification to the operator of the NASDAQ System of the desire to enter quotes.

(i)(h) Initiation of Service The registration of a NASDAQ options market maker in a given NASDAQ option shall be effective at the start of business on the second business day following receipt of his registration application by the Corporation; provided, however, said registration is accepted by the Corporation. If said registration is received for a NASDAQ option which option has not previously

been authorized by the Corporation, the registered NASDAQ options market maker's registration shall be effective at the start of business on the first day that the NASDAQ option is authorized for quotation by the Corporation.

(j)(i) Withdrawal Procedure

(1) With the approval of the Corporation, upon showing that it is seriously impaired in its ability to enter quotations, a registered NASDAQ options market maker may suspend its quotations for a specified period of time in the case of contemplated financing in the security, the presence of statutory prohibitions or restrictions, or such other reasons as may be acceptable to the Corporation.

(2) A registered NASDAQ options market maker who withdraws quotations may not re-enter quotations during the day without the prior approval of the Corporation.

(3) A registered NASDAQ options market maker whose quotation in any NASDAQ option is withdrawn, without the prior approval of the Corporation, at or before the daily close of the System shall have its registration in that NASDAQ option terminated subject, however, to the re-registration procedure set forth in paragraph (4) below.

(4) The registered NASDAQ options market maker may by making application to the Corporation under the procedures and requirements set forth in Section 2 of Part X of this Schedule D re-register as a registered NASDAQ options market maker in a NASDAQ option in which his registration is terminated pursuant to paragraph (3) above; provided, however, a registered NASDAQ options market maker may not re-enter quotations in the series of the NASDAQ option from which such NASDAQ options market maker had previously withdrawn until after one half of the time remaining to the expiration date of such NASDAQ option has elapsed. Such period shall not be ~~exceed one month nor be~~ for less than one week nor for more than one month.

(k)(j) Voluntary Termination A registered NASDAQ options market maker may voluntarily terminate its registration as to any NASDAQ option by withdrawing its quotations from the System.

(l)(k) Suspension and Termination of a Registered NASDAQ Options Market Maker's Authority to Enter Quotations by Action of the Corporation

(1) Suspension In extraordinary circumstances, and where required to promote just and equitable principles of trade, the Corporation, upon notice, may suspend a registered NASDAQ options market maker's authority to enter quotations into the System for up to two consecutive business days following the Corporation's action; provided, however, that when the Cor-

poration is engaged in an investigation of the registered NASDAQ options market maker's activities in connection with the suspension of quotations, and such investigation has not been completed by the end of the suspension period, the Corporation may extend the suspension for successive additional two consecutive business day periods as necessary.

(3) Termination The Corporation may, pursuant to provisions specified in the Code of Procedures for Handling Trade Practice Complaints, suspend, condition or terminate the registered NASDAQ options market maker's authority to enter quotations on one or more NASDAQ options for violation of the applicable rules of this Schedule D.

Section 4 - Options Contracts Authorized for Trading

The Corporation may from time to time approve for display on NASDAQ put option contracts and call option contracts in respect of underlying securities which have been selected in accordance with and which meet the criteria of Section 6 hereof. All such option contracts shall be designated as to the type of option, the underlying security, the expiration month and the exercise price. Only quotations in respect to option contracts in a class or series of options approved by the Corporation and currently open for display on NASDAQ may be quoted by a registered NASDAQ options market maker on the NASDAQ System.

Section 5 - Series of Options Open for Trading

(a) After a class of options has been approved for display on NASDAQ and quotation thereon by registered NASDAQ options market makers, the Corporation may from time to time open series of options in such class for display. Prior to the opening of trading in any series of options, the Corporation shall fix the expiration month and exercise price of option contracts included in each such series. At the commencement of display on NASDAQ of a particular class of options, series of options therein having three different expiration months will normally be opened. The first such expiration month shall be within approximately three months after such series is initially opened for display. Additional series of options of the same class may be opened for display on NASDAQ and quotation by registered NASDAQ options market makers at or about the time a prior series expires, and The expiration month of each such series shall normally be approximately nine months following the opening of such series. The exercise price of each series of options opened for display on NASDAQ and quoted by registered NASDAQ options market makers shall be fixed at a price per share which is reasonably close to the price per share at which the underlying security is traded ~~in the primary markets~~ at or about the time such series of options is first opened for display on NASDAQ. Additional series of options of the same class may be opened for display on NASDAQ as

the market price of the underlying security moves substantially from the initial exercise price or prices but in no event shall the exercise price be less than \$10. ~~The opening of a new series of options for display on NASDAQ shall not per se affect any other series of options of the class previously opened.~~

(b) No transaction in NASDAQ option contracts of a particular series of NASDAQ options shall be effected after 3:00 p.m. Eastern Time on the business day prior to the expiration date of that series.

(c) The unit of trading and the exercise price initially established for option contracts of a particular series are subject to adjustment by the Options Clearing Corporation in accordance with the rules of the Options Clearing Corporation. When such adjustment or adjustments have been determined, announcement thereof shall be made by the Corporation and effective as of the time specified in such announcement, the adjusted unit of trading and the adjusted exercise price shall be applicable with respect to all subsequent transactions in such series of options.

Section 6 - Qualifications for Authorized Underlying Securities

(a) The authorized underlying securities eligible to be subject to NASDAQ options shall be determined solely by the Corporation. Said determination shall be in accordance with the criteria established pursuant to the Participant Agreement entered into by the Corporation with the Options Clearing Corporation and this Section. The criteria specified in the Participant Agreement are as follows:

(1) Such security is registered under Section 12(g)(1) of the Securities Exchange Act of 1934, as amended, and displayed on the NASDAQ System; or is registered on a national securities exchange in accordance with the requirements of Section 12(b) of the Securities Exchange Act of 1934, as amended; or it is issued by an insurance company meeting the conditions of Section 12(g)(2)(G) of the Securities Exchange Act of 1934, as amended;

(2) The issuer thereof has complied with the reporting and disclosure requirements of Sections 13 and 14 of the Securities Exchange Act of 1934, as amended, unless exempted therefrom;

(3) A majority of the existing board of directors of the issuer thereof have been directors of the issuer, or a predecessor of the issuer, from the beginning of the issuer's last three fiscal years;

(4) The issuer thereof and any of its subsidiaries have not during the past three fiscal years defaulted in the payment of any dividend or sinking fund installment on preferred stock, or on any indebtedness for borrowed money or in the payment of rentals under long term leases; and

(5) The issuer thereof (including its consolidated subsidiaries) had a net income, after taxes but before extraordinary items net of tax effect, of at least \$250,000 for each of the last three fiscal years.

(b) The following additional criteria must be met in order for a security to qualify to be an authorized underlying security for NASDAQ options:

(1) The issuer thereof has a minimum of 10 million outstanding shares in each class of security on which options are to be authorized at least 8 million of which are beneficially owned by persons other than officers or directors of the issuer or 10% stockholders;

(2) There are a minimum of 10,000 ~~holders~~ beneficial owners of said such security;

(3) There was aggregate trading volume reported to the NASDAQ System and/or the securities exchanges on which the security is listed of at least one million shares per year in each of the two previous calendar years; and

(4) There is a representative bid of at least \$10 per share.

(c) Notwithstanding the criteria set forth in ~~paragraph subsection~~ (b) above, the Corporation may from time to time change or make exceptions to one or more of such criteria in particular cases. ~~Underlying securities initially meeting the referred to criteria will not necessarily be eliminated from the authorized list should they subsequently cease to meet one or more of the stated criteria.~~

(d) Once qualified, the following criteria must be met in order for a security to continue to be an authorized underlying security for NASDAQ options:

[Maintenance criteria relative to the continued qualifications for NASDAQ options will be developed.]

Section 7 - Units of Trading

The unit of trading in each series of options displayed on NASDAQ shall be the unit of trading established ~~for that series~~ by the Options Clearing Corporation pursuant to the rules of the Options Clearing Corporation.

Section 8 - Suspension of an Authorized Underlying Security and/or its Option

(a) In particular instances, where the Corporation deems it necessary and appropriate in order to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to protect investors or the public interest, to insure a fair and orderly market, to assure adequate trading interest and the likelihood of a competitive market, or if one or more of the events set forth in subsection (b) hereof occur, it may suspend an authorized underlying security and/or its NASDAQ option from quotation on the NASDAQ System.

(b) An authorized underlying security and/or its NASDAQ option shall be subject to suspension if:

(1) It has been and is currently suspended from being traded over-the-counter by the Securities and Exchange Commission pursuant to Section ~~15(e)(5)~~ 12(k) of the Securities Exchange Act of 1934, as amended;

(2) There has been and is currently a failure by the issuer promptly to disclose to the public through the press any material information which may affect the value of its securities or influence investors' decisions;

(3) There has been and is currently a failure to file with the Corporation, the issuer's annual and quarterly reports required to be filed with the Securities and Exchange Commission. Issuers which are not required by law to file an annual or quarterly report with the Securities and Exchange Commission must file with the Corporation their annual and quarterly reports required to be filed with the appropriate regulatory authority; and

(4) There has been and is currently a failure to comply with any obligation of any person regarding filing or disclosure of material information whether the obligation arises under a federal or state statute or rule and the Corporation shall determine that the public interest requires suspension.

(c) The Corporation may make exceptions to the application of the criteria set forth in subsections (a) or (b) hereof if considered necessary and appropriate in the public interest.

[The material originally published under Sections 9 through 11, which dealt with Liquidation of Positions, Limit on Uncovered Short Positions and Restriction on Option Transactions and Exercises now appears as Sections 6, 7 and 8 of Appendix E to Article III, Section 33 of the Rules of Fair Practice.]

Section 9 - Trade Comparison Procedures for NASDAQ Options

(a) Scope and Applicability

All over-the-counter transactions in NASDAQ options shall be reported for comparison to the Corporation pursuant to procedures for such established by the Corporation. The Corporation shall report all compared transactions to the Options Clearing Corporation for clearance and settlement. All compared transactions in NASDAQ options which are cleared and settled through the facilities of the Options Clearing Corporation shall be subject to the rules of the Options Clearing Corporation.

(b) Responsibility of Clearing Members

A clearing member shall be responsible for the clearance and settlement of every NASDAQ option transaction to which it is a party and each NASDAQ transaction of a non-clearing member with which the clearing member has entered into a written agreement in a form approved by the Corporation.

(c) Trade Reporting and Comparison

(1) A clearing member shall report its trades individually for each business day to the Corporation at a location, time and in the manner specified by the Corporation.

(2) Each business day, the Corporation will perform a comparison and matching of each item of information reported to the Corporation by the clearing member.

(3) The Corporation will make available to the clearing member daily reports summarizing transactions for each NASDAQ option, on such form as may be determined by the Corporation, for each account maintained by such clearing member with the Options Clearing Corporation. Such reports shall reflect all trades reported.

(4) Each clearing member shall promptly check each report received, reconcile all unreported and advisory trades, including any errors or omissions and report corrected trade information to the other clearing members concerned and to the Corporation as soon as possible, but in any event not later than the hour which shall be from time to time prescribed by the Corporation. It shall be the sole responsibility of the clearing member to check the accuracy of all reports promptly upon receipt, and the Corporation shall not assume any responsibility for checking the accuracy of such reports or for making any corrections not reported by a clearing member.

(5) Upon receipt of the clearing member's corrected report, the Corporation will make available to the clearing member a final unreconciled trade report. Such report will contain all uncomparing and advisory trades for the clearing member. Any trades contained on this report which are then reconciled by the clearing member prior to 10:00 a.m. Eastern Time of the next business day shall be submitted to the Corporation on that day in accordance with the provisions set forth in subsection (1) above.

(6) In the event a clearing member cannot resolve an uncomparing trade prior to 10:00 a.m. Eastern Time on the first business day following the trade date, such clearing member shall close out the transaction as prescribed in paragraph (7) hereafter.

(7) When a disagreement between Corporation members arising from an uncomparing NASDAQ option transaction cannot be resolved by mutual agreement prior to 10:00 a.m. Eastern Time on the first business day following the trade date, the parties shall promptly, but not later than 3:30 p.m. Eastern Time on such day, close out the transaction in the following manner. The member representing the purchaser in the uncomparing NASDAQ option transaction shall enter into a new NASDAQ option transaction to purchase the option contract that was the subject of the uncomparing NASDAQ option transaction. The member representing the writer in the uncomparing NASDAQ option transaction shall enter into a new NASDAQ option transaction to sell (write) the option contract that was the subject of the uncomparing NASDAQ option transaction. The purchase and sale (writing) of new option contracts in such a manner shall serve to nullify an uncomparing NASDAQ option transaction; provided, however, the appropriate reversing transactions closing out the original uncomparing NASDAQ option transaction are also submitted to the Corporation. All such purchase and writing (sale) transactions shall then be submitted to the Corporation on the next business day in accordance with the provisions set forth in subsection (1) above. All claims for damages resulting from uncomparing NASDAQ option transactions must be made promptly for the accounts of the members involved and not for the accounts of their respective customers.

Section 10 - Clearance and Settlement Procedures for NASDAQ Options

(a) Whenever the Options Clearing Corporation shall reject a NASDAQ option transaction because of the failure of a clearing member acting on behalf of the purchaser to pay the premium due thereon as required by the rules of the Options Clearing Corporation, the clearing member acting as or on behalf of the seller (writer) shall have the right either to cancel the transaction by giving notice thereof to the defaulting clearing member or to enter into either a new opening writing transaction or closing sale transaction, as the case may be, in respect of the same option contract that was the subject of the rejected NASDAQ option transaction, charging any loss resulting therefrom (including any commissions paid or payable in connection with such new

transaction) to the defaulting clearing member. Such action shall be taken as soon as possible but in any event not later than the close of trading on the day the NASDAQ option transaction was rejected by the Options Clearing Corporation, unless the Corporation shall extend such time.

(b) When announcement is made of the suspension of a member, other than a clearing member of the Options Clearing Corporation, pursuant to the By-Laws of the Corporation, all open short positions of the suspended non-clearing member in option contracts and all open positions resulting from the exercise of option contracts, other than positions that are secured in full by a specific deposit or evidenced by an escrow receipt in accordance with the rules of the Options Clearing Corporation, shall be closed without unnecessary delay by all members carrying such positions for the account of the suspended non-clearing member; provided, however, that upon any such suspension, the Corporation may, in its sole discretion and where it determines that such is necessary for the protection of investors, suspend the mandatory close-out provisions hereof and may, in its sole discretion and where it determines that such is necessary for the protection of investors, reinstate such provisions at such time as it may determine. No temporary suspension of the mandatory close-out provisions hereof shall relieve any suspended non-clearing member of its obligations or of any damages incurred by members carrying positions for the account of such suspended non-clearing member. When a clearing member of the Options Clearing Corporation is suspended pursuant to the provisions of the By-Laws, the positions of such clearing member shall be closed out in accordance with the rules of the Options Clearing Corporation.

Section 11 - Tendering Procedures for Exercise of NASDAQ Options

(a) Subject to the restrictions established pursuant to Section 4, Appendix E to Section 33 of the Rules of Fair Practice, and such other restrictions which may be imposed by the Corporation or the Options Clearing Corporation pursuant to appropriate rules, an outstanding NASDAQ option contract may be exercised during the time period specified in the rules of the Options Clearing Corporation by the tender to the Options Clearing Corporation of an exercise notice in accordance with the rules of the Options Clearing Corporation. An exercise notice may be tendered to the Options Clearing Corporation only by the clearing member in whose account the option contract is carried. The exercise cut-off time for all members shall be such time on the business day immediately prior to the expiration date as may be fixed from time to time by the Corporation. The exercise cut-off time shall also apply in respect of option contracts carried in any proprietary account of such member as the latest time at which such member, if it is a clearing member, shall tender exercise notices to the Options Clearing Corporation, or if it is not a clearing member, shall issue exercise instructions to its clearing member.

(b) Notwithstanding the provisions of subsection (a) hereof, members may receive exercise instructions and tender exercise notices after the exercise cut-off time but prior to expiration date: (1) in the case of option contracts carried in an account maintained for another member in which only positions of customers of such other member are carried; (2) in order to remedy mistakes or errors made in good faith; (3) to take appropriate action as the result of a failure to reconcile unmatched NASDAQ option transactions; or (4) where extraordinary circumstances relating to a public customer's inability to communicate exercise instructions to the member (or the member's inability to receive exercise instructions) prior to such cut-off time warrant such action.

(c) Each member shall establish fixed procedures for the allocation of exercise notices assigned in respect of a short position in option contracts in such member's customer accounts. Such allocation shall be on a "first in, first out" basis, on a basis of random selection or another allocation method that is fair and equitable to the customers of such member; provided, however, that such method of allocation may provide that an exercise notice of block size will, to the extent possible, be allocated to a customer or customers having an open short position in options of block size and that an exercise notice of less than block size will, to the extent possible, be allocated to a customer having a short position of less than block size. For purposes of this Section, an exercise notice or a short position with respect to 25 or more units of trading of the same class of options shall be deemed to be of "block size."

Each member shall report its proposed method of allocation to the Corporation and obtain the Corporation's prior approval thereof, and no member shall change its method of allocation unless the change has been reported to and been approved by the Corporation. Each member shall, upon the request of a customer, furnish to such customer a description of the method used by it in assigning exercise notices to the accounts of customers.

(d) Delivery of the shares of an underlying security upon the exercise of an option contract and payment of the aggregate exercise price in respect thereto, shall be effected in accordance with the rules of the Options Clearing Corporation. As promptly as practicable after the exercise of a call option contract by a customer, the member shall require the customer to make full cash payment of the aggregate exercise price, or make the required margin deposit in respect thereto, if such transaction is effected in a margin account, in accordance with the applicable regulations of the Federal Reserve Board and Section 30 of the Rules of Fair Practice. As promptly as practicable after the assignment to a customer of an exercise notice in respect of a call option contract, the member shall, if the shares of the underlying security are not carried in the customer's account, require the customer to deposit the shares of the underlying security, or to make the required margin deposit in respect thereof, if such transaction is effected in a margin account, in accordance with Section 30 of the Rules of Fair Practice and the applicable regulations of the Federal Reserve Board.

(e) Each member shall file with the Corporation, as of the 10th of each month, a report of all open positions resulting from the exercise of option contracts in accounts carried by such member.

Section 12 - Rules of General Applicability

The provisions of Parts IV and IX of Schedule D of Article XVI of the By-Laws, shall to the extent not inconsistent with the provisions hereof, apply to NASDAQ options.

PROPOSED AMENDMENTS TO SCHEDULE C OF
ARTICLE I, SECTION 2(d) OF THE BY-LAWS

Part I,
Section 4

Every member of the Corporation which is engaged in, or which intends to engage in transactions in put or call options with the public, or ~~for the account of the member~~ for its own account, shall have at least one Registered Options Principal who shall have satisfied the requirements of Part II, Section 2(f) hereof. A member which has a Registered Options Principal qualified in either put or call options shall not engage in both put and call option transactions until such time as it has a Registered Options Principal qualified in both such options. Every person actively engaged in the management, direction or supervision of the day-to-day activities of a member shall also be registered as a Registered Options Principal.

Part II,
Section 2

(f)(1) Each person required by Part I, Section 4 hereof to be a Registered Options Principal shall pass the appropriate qualification examination for Registered Options Principal, or an equivalent acceptable to the Corporation, and be registered as such before engaging in the duties or accepting the responsibilities of a Registered Options Principal. (2) A person shall not qualify as a Registered Options Principal for both put and call options unless he has passed an examination testing him with respect to both put and call options.

PROPOSED AMENDMENT TO ARTICLE III,
SECTION 30, OF THE RULES OF FAIR PRACTICE

Article III, Section 30, Appendix A, Section 4(a)(ii)

"(ii) in the case of puts and calls listed or traded on a registered national securities exchange or displayed in the NASDAQ System, 30 percent of the market value of the equivalent number of shares of the underlying security, plus any unrealized loss or less any unrealized profit;"