



RULE  
ADOPTION  
NOTICE

**RAN-02-06**  
**March 26, 2002**

**TO: All PCX Member and Member Organizations**

**FROM: Department of Regulatory Policy**

**SUBJECT: Rule Relating to Adoption of New Sanctioning Guidelines for Enforcing Compliance With the Exchange's Options Order Handling Rules**  
**(File No. SR-PCX-2001-23)**

On March 15, 2002, the Securities and Exchange Commission ("SEC") approved an Exchange rule proposal relating to adoption of new sanctioning guidelines to assist the Exchange in enforcing compliance with its options order handling rules. New Rule 10.15 sets forth both general guidelines to be followed in all disciplinary matters and also sets forth specific fine levels for disciplinary matters initiated as a result of violations of the Exchange's rules relating to firm quote (Rule 6.86), limit order display (Rule 6.55), obligations of market makers, priority (Rule 6.75), best execution (Rule 6.46), and trade reporting (Rule 6.69). Various Exchange bodies that adjudicate disciplinary actions, including the PCX Board of Governors, the Ethics and Business Conduct Committee, and the PCX Surveillance and Enforcement Departments, for in-house adjudications, in determining appropriate remedial sanctions, will use these guidelines.

Following is the text of new Rule 10.15, which the SEC has approved. Questions regarding this notice may be addressed to Hassan Abedi, Manager, Enforcement at (415) 393-5958.

## EXHIBIT A

### Text of the Rule Change<sup>1</sup>

#### Pacific Exchange, Inc.

---

#### Pacific Exchange Sanctioning Guidelines

##### Rule 10.15 (a) Overview

The mission of the Pacific Exchange, Inc. ("PCX" or "Exchange") is to provide a securities marketplace in which high standards of honor and integrity prevail and to promote and maintain just and equitable principles of trade and business. To this end, as a regulator, the PCX seeks to protect investors and strengthen market integrity through vigorous, even-handed, and cost-effective self-regulation. The PCX embraces self-regulation as the most effective means of infusing a balance of industry and non-industry expertise into the regulatory process. To build public confidence in the financial markets, and as part of the PCX's regulatory mission, the PCX must stand ready to discipline members, member organizations, their employees, and approved persons by imposing sanctions when necessary and appropriate to protect investors, members, member organizations and the marketplace as a whole and to promote the public interest.

These Sanctioning Guidelines have been developed for use by the various Exchange bodies that adjudicate disciplinary actions, including the PCX Board of Governors, the Ethics and Business Conduct Committee, the PCX's Surveillance and Enforcement Departments, for in-house adjudications, (collectively, "Adjudicatory Bodies" or "Adjudicators"), in determining appropriate remedial sanctions. These Guidelines also may be used by parties to a disciplinary action in entering into a Stipulation of Facts and Consent to Penalty.

These Guidelines do not prescribe fixed sanctions for particular violations. Rather, they provide direction for Adjudicatory Bodies to assist them in imposing sanctions consistently and fairly. The Guidelines recommend ranges for sanctions and suggest factors (called "Principal Considerations") that Adjudicatory Bodies may consider in determining, for each case, where within the range the sanctions should fall or whether sanctions should be above or below the recommended range. These Guidelines are not intended to be absolute. Based on the facts and circumstances presented in each case, Adjudicatory Bodies may impose sanctions that fall outside the ranges recommended and may consider aggravating and mitigating factors in addition to those listed in these Guidelines.

---

<sup>1</sup> New text is underscored.

To promote consistency and uniformity in the imposition of penalties, the following General Principals should be considered in connection with the imposition of sanctions in all cases. In addition, a list of Principal Considerations in Determining Sanctions, which enumerates generic factors that could be aggravating or mitigating in any given case, is included.

(b) General Principles Applicable to All Sanction Determinations.

(1) Disciplinary sanctions are remedial in nature. Adjudicatory Bodies should design sanctions to prevent and deter future misconduct by the wrongdoer, to discourage others from engaging in similar misconduct, and to improve overall business and ethical standards of PCX members. The concept of remediation calls for the imposition of the least burdensome sanction necessary effectively to address the misconduct. The concept of deterrence requires the imposition of a remedial sanction of sufficient weight to discourage the violator and others similarly situated from repeating or engaging in the misconduct. Disciplinary sanctions should not be designed to punish for past misconduct. Rather, Adjudicatory Bodies should seek to achieve remediation and deterrence in imposing sanctions.

(2) An important objective of the disciplinary process is to deter future misconduct by imposing progressively escalating sanctions on recidivists. Repeated acts of misconduct call for increasingly serious sanctions. It should be noted, however, that even if a named party has no history of misconduct, the misconduct at issue may be so egregious as to justify sanctions beyond the range recommended in these Guidelines. Adjudicatory Bodies should consider a named party's relevant disciplinary history in determining sanctions. Relevant history may include past misconduct similar to the misconduct at issue or past misconduct that, while unrelated, evidences prior disregard for regulatory requirements, investor protection, or the integrity of the industry as a whole. Certain regulatory incidents are not relevant to the determination of disciplinary sanctions. Examples are: settlements containing an express agreement prohibiting consideration of the action for purposes of enhancement of sanctions in subsequent actions; arbitration proceedings, whether pending, settled or fully litigated; and pending regulatory investigations or the existence of ongoing regulatory proceedings prior to the issuance of a decision.

(3) Adjudicatory Bodies should tailor sanctions to address the misconduct at issue. In order to achieve remediation, Adjudicatory Bodies should impose sanctions tailored to the misconduct at issue. While adhering to the limitations with respect to sanctions imposed by the Securities Exchange Act of 1934 and the PCX's own rules, Adjudicatory Bodies may consider imposing somewhat unique sanctions if necessary to address the specific misconduct at issue. For example, an Adjudicatory Body may require a member or member organization to: retain a qualified independent consultant to improve future compliance with regulatory requirements; disclose disciplinary history to new and/or existing clients; or implement heightened supervision of certain employees.

(4) Aggregation or "batching" of violations may be appropriate in certain instances for purposes of determining sanctions. Adjudicatory Bodies may treat several acts of misconduct as one "violation" for purposes of determining sanctions if the misconduct meets certain objective parameters. The parameters are intended to describe the circumstances in which Adjudicatory Bodies may choose to aggregate violations and are not intended to require that Adjudicators aggregate multiple violations in every instance in which the violations meet the parameters. Multiple violations may be treated individually such that a sanction is imposed for each violation, and multiple violations may be treated as aggravating and warrant higher sanctions. In determining whether to aggregate, Adjudicatory Bodies should consider the following factors:

(A) Whether the violations involved related activity and the same or similar interrelated rules or regulations. (If aggregated, the violations should not have involved materially different types of misconduct.)

(B) Whether the violations involved unintentional or negligent misconduct or manipulative, fraudulent, or deceptive intent. (If aggregated, the violations should not have involved manipulative, fraudulent, or deceptive intent.)

(C) Whether the misconduct resulted in injury to investors. (If investors were injured, but the misconduct did not involve manipulative, fraudulent, or deceptive intent and full restitution has been paid to all injured parties, an Adjudicatory Body may consider aggregating violations. Otherwise, violations involving customer harm should not be aggregated.)

(D) Whether the violations resulted from a single systematic problem or underlying cause that has been corrected. (If aggregated, the violations should have resulted from one cause and the cause should have been corrected.)

(5) Adjudicatory Bodies should order restitution if necessary to remediate misconduct. Adjudicatory Bodies should order restitution when an identifiable party has suffered a quantifiable loss as a result of a named party's misconduct. Restitution is particularly appropriate when a named party has benefited from the misconduct. Furthermore, while restitution is an appropriate method of depriving a wrongdoer of ill-gotten gain, as discussed in the sixth principle, the amount of ill-gotten gain also may be used to determine the amount of a disciplinary fine. Adjudicatory Bodies should calculate orders of restitution based on the actual amount of loss sustained by the injured party, as demonstrated by record evidence. Orders of restitution may exceed the amount of the named party's ill-gotten gain. It is imperative that Adjudicatory Bodies include in written decisions a description of the method used to calculate restitution.

(6) Adjudicatory Bodies may consider the amount of a named party's ill-gotten gain when determining the amount of a disciplinary fine. In cases in which the record demonstrates that a named party obtained a financial benefit from its misconduct, Adjudicatory Bodies may require disgorgement of the ill-gotten gain by fining away the amount of the financial benefit.

(7) Adjudicatory bodies may require approved persons and other registered employees of members or member organizations to requalify in any or all registered capacities or to obtain additional training before continuing as floor officials. The remedial purpose of disciplinary sanctions may be served best by requiring a named party who is a registered employee of a member or member organization to requalify by examination as a condition of continued employment in the securities industry. Similarly, it may be appropriate to require a named party to receive additional training before allowing the party to continue to act as a floor official. These types of sanctions are particularly appropriate in cases in which a named party's actions demonstrate a lack of knowledge or familiarity with the rules and laws governing the securities industry.

(8) Adjudicatory Bodies may consider a named party's inability to pay in connection with the imposition of monetary sanctions when the party raises this issue. When raised by a named party, Adjudicatory Bodies may consider a proven *bona fide* inability to pay when determining monetary sanctions. The burden is on the named party to raise the issue of inability to pay and to provide evidence of inability. Proof of inability to pay need not result in a reduction or waiver of monetary sanctions, but could instead result in the imposition of an alternate payment option or alternate sanction.

(c) These General Principles are applicable to all sanctions determinations and should be considered by Adjudicatory Bodies in all cases. Consistency and uniformity are important in the application of disciplinary sanctions and, for this reason, these guiding principles are extremely important to the continued fairness of the PCX disciplinary process.

(d) Principal Considerations In Determining Sanctions. The following list of factors should be considered in conjunction with the imposition of sanctions. Individual guidelines may list other factors. As appropriate, Adjudicatory Bodies should consider case-specific factors in addition to those listed here and in individual guidelines.

(1) The named party's relevant disciplinary history. (See General Principle No. 2).

(2) Whether the named party accepted responsibility for and acknowledged the misconduct to an employer (in the case of an employee of a member or member organization or an approved person) or a regulator prior to detection and intervention by the employer or regulator.

(3) Whether the named party voluntarily employed subsequent corrective measures, prior to detection or intervention by an employer (in the case of an employee of a member or member organization or an approved person) or a regulator, to revise general and/or specific procedures to avoid recurrence of misconduct.

(4) Whether the named party voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct.

(5) Whether the named party demonstrated reasonable reliance on competent legal, compliance, or accounting advice.

(6) Whether the named party engaged in numerous acts and/or a pattern of misconduct.

(7) Whether the named party engaged in the misconduct over an extended period of time.

(8) Whether the named party attempted to conceal misconduct or to lull into inactivity, mislead, deceive, or intimidate a customer, regulatory authorities, or an employer (in the case of an employee of a member or member organization or an approved person).

(9) With respect to other parties, including the investing public and/or other market participants, (a) whether the named party's misconduct resulted directly or indirectly in injury to such other parties; and (b) the extent of the injury.

(10) Whether the named party provided substantial assistance to regulators in its examination and/or investigation of the underlying misconduct, or whether the named party attempted to delay an investigation, to conceal information, or to provide inaccurate or misleading testimony or documentary information to the PCX or another regulator.

(11) Whether the named party's misconduct was the result of an intentional act, recklessness, or negligence.

(12) Whether the named party engaged in the misconduct at issue notwithstanding prior warnings from PCX staff, another regulator, or a supervisor (in the case of an approved person or employee of a member or member organization) that the conduct violated PCX rules or applicable securities laws or regulations.

(13) Whether the named party's misconduct resulted in the potential for monetary or other gain.

(14) The number, size, and character of the transactions at issue.

(15) The level of sophistication of the injured or affected customer.

(16) Whether, at the time of the violation, the named member or member organization had developed reasonable supervisory, operational, and/or technical procedures or controls that were properly implemented.

(17) Whether, at the time of the violation, the named member or member organization had developed adequate training and educational initiatives.

(18) Whether the named member or member organization can demonstrate that the misconduct at issue was aberrant or not otherwise reflective of its historical compliance record.

(19) Whether the member or member organization with which a named party is/was associated disciplined the party for the misconduct at issue prior to regulatory detection.

(e) Specific Sanctioning Guidelines for Options Order Handling Rules.

(1) Firm Quotes – PCX Rule 6.86

(A) Principal Considerations in Determining Sanctions.

(i) See list of principal considerations applicable to all violations.

(ii) Whether named party remediated the failures to execute.

(B) Monetary Sanctions.

- (i) First Disciplinary Action Fine of \$500 to \$5,000.
- (ii) Second Disciplinary Action Fine of \$1,000 to \$10,000.
- (iii) Subsequent Disciplinary Actions Fine of \$3,000 to \$50,000.

Commentary:

.01 To determine if an action is the first disciplinary action, consider disciplinary actions with respect to violative conduct that occurred within the two years prior to the misconduct at issue. As indicated in the General Principles, recent acts of similar misconduct may be considered to be aggravating factors.

(C) Suspension, Expulsion, or Other Sanctions. In egregious cases, consider suspending the named party with respect to any or all activities or functions for up to two years.

(2) Limit Order Display – PCX Rule 6.55<sup>2</sup>

(A) Principal Considerations in Determining Sanctions.

- (i) See list of principal considerations applicable to all violations.
- (ii) Whether customer limit order was executed during the period of non-compliance.
- (iii) Whether other transactions were executed at prices equal to or better than the customer limit order.
- (iv) Whether misconduct had a significant adverse impact on market transparency and availability of price information.
- (v) Amount of time beyond 30 seconds that elapsed before limit order was displayed.

(B) Monetary Sanctions.

- (i) First Disciplinary Action Fine of \$1,000 to \$5,000.
- (ii) Second Disciplinary Action Fine of \$2,000 to \$10,000.
- (iii) Subsequent Disciplinary Actions Fine of \$5,000 to \$50,000.

Commentary:

.01 To determine if an action is the first disciplinary action, consider disciplinary actions with respect to violative conduct that occurred within the two years prior to the misconduct at issue. As indicated in the General Principles, recent acts of similar misconduct may be considered to be aggravating factors.

(C) Suspension, Expulsion, or Other Sanctions. In egregious cases, consider suspending the named party with respect to any or all activities or functions for up to two years. In particularly egregious cases involving a pattern of misconduct, consider expelling the member or member organization.

---

<sup>2</sup> The Exchange's "Limit Order Display Rule" for options currently is pending approval at the SEC.

withdrawing approval of the responsible approved person, and/or permanently barring a named party from employment or association with any member or member organization.

(3) Priority Rules and Obligations of Market Makers – PCX Rules 6.37 and 6.75.

(A) Principal Considerations in Determining Sanctions.

(i) See list of principal considerations applicable to all violations.

(ii) Whether the misconduct involved violations of rules intended to provide protection to customer orders.

(iii) Whether misconduct resulted in the failure to execute a customer order and, if so, whether the named party remediated the misconduct.

(B) Monetary Sanctions.

(i) First Disciplinary Action Fine of \$1,000 to \$5,000.

(ii) Second Disciplinary Action Fine of \$2,000 to \$20,000.

(iii) Subsequent Disciplinary Actions Fine of \$5,000 to \$50,000.

Commentary:

.01 To determine if an action is the first disciplinary action, consider disciplinary actions with respect to violative conduct that occurred within the two years prior to the misconduct at issue. As indicated in the General Principles, recent acts of similar misconduct may be considered to be aggravating factors.

(C) Suspension, Expulsion, or Other Sanctions. In egregious cases, consider suspending the named party with respect to any or all activities or functions for up to two years. In particularly egregious cases involving a pattern of misconduct and/or customer harm, consider expelling the member or member organization, withdrawing approval of the responsible approved person, and/or permanently barring a named party from employment or association with any member or member organization.

(4) Best Execution – PCX Rule 6.46.

(A) Principal Considerations in Determining Sanctions.

(i) See list of principal considerations applicable to all violations.

(ii) Whether the misconduct involved violations of rules intended to provide protection to customer orders.

(iii) Whether a customer was disadvantaged because of the Floor Broker's failure to exercise due diligence.

(iv) Whether the misconduct resulted in the failure to execute a customer order, if so, whether the wrongdoer remediated the misconduct.

(v) Whether the wrongdoer acted with intent to disadvantage a customer.

(B) Monetary Sanctions.

- (i) First Disciplinary Action Fine of \$1,000 to \$5,000.
- (ii) Second Disciplinary Action Fine of \$3,000 to \$10,000.
- (iii) Subsequent Disciplinary Actions Fine of \$10,000 to \$25,000.

Commentary:

.01 To determine if an action is the first disciplinary action, consider disciplinary actions with respect to violative conduct that occurred within the two years prior to the misconduct at issue. As indicated in the General Principles, recent acts of similar misconduct may be considered to be aggravating factors.

(C) Suspension, Expulsion, or Other Sanctions. In egregious cases, consider suspending the named party with respect to any or all activities or functions for up to two years. In particularly egregious cases involving a pattern of misconduct and/or customer harm, consider expelling the member or member organization, withdrawing approval of the responsible approved person, and/or permanently barring a named party from employment or association with any member or member organization.

(5) Trade Reporting – PCX Rule 6.69.

(A) Principal Considerations in Determining Sanctions.

- (i) See list of principal considerations applicable to all violations.
- (ii) The extent of the abuse i.e. whether a pattern of abuse exists, and the number of transactions involved.
- (iii) Presence of intent, recklessness, or negligence.
- (iv) The nature of trade-reporting violation.
- (v) Whether the violative conduct affected discovery of information regarding market price.
- (vi) The amount of time beyond 90 seconds that elapsed before trade was reported.
- (vii) Whether the wrongdoer remediated the misconduct.

(B) Monetary Sanctions.

- (i) First Disciplinary Action Fine of \$1,000 to \$5,000.
- (ii) Second Disciplinary Action Fine of \$3,000 to \$10,000.
- (iii) Subsequent Disciplinary Actions Fine of \$10,000 to \$50,000.

Commentary:

.01 To determine if an action is the first disciplinary action, consider disciplinary actions with respect to violative conduct that occurred within the two years prior to the misconduct at issue. As indicated in the General Principles, recent acts of similar misconduct may be considered to be aggravating factors.

(C) Suspension, Expulsion, or Other Sanctions. In egregious cases, consider suspending the named party with respect to any or all activities or functions for up to two years. In particularly egregious cases involving a pattern of misconduct and/or customer harm, consider expelling the member or member organization, withdrawing approval of the responsible approved person, and/or permanently barring a named party from employment or association with any member or member organization.