



Date: February 8, 2002

To: Options Exchanges

From: SIA Options Committee

Re: *Quality of Execution Reporting
Recommendations - Phase One*

The lack of uniformity among best-execution reports furnished by each of the options exchanges makes it difficult for users to compare execution quality across these markets. This lack of standardization coupled with strong regulatory pressure to assess execution quality has prompted the SIA Options Committee to solicit recommendations on uniformity from the member firm community. With that in mind, a best-ex sub-committee was formed. The committee is please to offer these recommendations to the options exchanges for use in preparing reports that may be requested of them by firms pursuant to their best execution monitoring programs.

While the Committee believes that these recommendations, if implemented, will improve a firm's ability to evaluate data, a complete and accurate assessment of a firm's order routing decisions will not be possible until such critical market structure elements as a complete linkage, the dissemination of size with quotations, and a consolidated NBBO are in place. While uniform data elements will no doubt improve the comparison process, the integrity of the underlying data being compared will continue to be suspect until such time as the market structure initiatives described above have been implemented. In recognition of the lack of reliable raw data and existing structural impediments to execution quality, the SEC has so far refused to apply the execution quality disclosure rules to the options markets. As such, these recommendations do not constitute industry endorsement of best execution or order execution quality standards for the options markets. Firms are advised to carefully consider the role of execution quality data in their best execution policies and procedures, and to consider such changes as may be appropriate as market structure reforms are implemented.

The committee recognizes that implementing these recommendations may require a substantial amount of work by the exchanges. However, the committee feels strongly that we keep this process moving. We would therefore request that each exchange provide the committee with a timetable reflecting specific target dates for delivery of the report and any future enhancements that it contemplates.

Current Recommendations

1. Reports should be:

- Online (web based), password protected, and downloadable.
- In Excel format (this makes for easier file storage and sorting/merging processes).
- Formatted as recommended.

2. Required Reports (DAILY):

A. Exception Report in alphabetical order by class for the entire trading day. The first 5 minutes (9:30 A.M. - 9:35 A.M. EST) and last 5 minutes (3:57 P.M. - 4:02 P.M. EST) of the trading day should be included in a separate section at the end of the daily exception report.

B. Month to Date Exception Summary sorted by class. This should be a running recap of the daily report described above. This report should be sorted by date.

C. Month to Date summary of when markets are removed from the NBBO calculation. This report should be sorted by date.

(MONTHLY):

D. Monthly Statistical Report covering each member firm's order flow in its entirety.

3. Orders to Include:

- All market and marketable limit orders.
- All limit orders resting on the book that subsequently becomes marketable.
- All classes that trade on the exchanges should be monitored.

4. Orders to Exclude:

- Stop orders.
- Not held orders.
- Orders with special handling instructions.
- Flex option trades.

5. "Execution Time" should be used when calculating NBBO for "Phase One" of this project. However, the vast majority of Sub-Committee members agreed that the use of receipt time is our ultimate goal. In an effort to expedite the initial release of standardized reporting, the committee agreed to recommend the use of execution time with the intent of pushing for a more accurate accounting, namely receipt time, during "Phase Two" of this project. In the interim, the Monthly Exchange Report should be broken down into size categories so that member firms can monitor turnaround times.

6. "Receipt Time" should be universally defined as the time an order is captured in a market center's automated order handling system.

7. "Price Improvement" should be universally defined as 1-trading increment better than the NBBO e.g., executing a trade at the currently displayed NBBO, even if the executing exchange is responsible for the NBBO, is NOT price improvement.

8. A "Trade Through" occurs when all or any part of an order, regardless of size, trades through the current NBBO i.e., an exchange honoring a stated size guarantee at the NBBO and trading the remaining quantity through NBBO is a "Trade Through."

9. "Exception Codes" should be standardized. Taken collectively there are over 30 exceptions codes currently used by the exchanges. The Sub-Committee recommends that a small "core" number of exceptions be used across exchanges.

The Committee Recommends:

- PA - Price Adjusted to NBBO.
- PT - Post Trade Quote
- FQ - Flashing Quote
(rapid multiple quote changes prevents reasonable attempt to obtain apparent NBBO).
- MF - Away Market Faded
(sent order, away market refused to honor posted market).
- FA - Fast Market Away
(fast market declared and indicated by the away exchange prevents reasonable attempt to obtain apparent NBBO).
- BP - Bad Print (identify exchange responsible)
- FD - Firm Discretion
- OE - Other Exceptions. All other reasons that an order showing up on the exception report should be recorded in this column with a detailed explanation.

The vast majority of exceptions should fall under the above "core" exceptions. The Sub-Committee encourages the exchanges to include explanations with all exceptions in the "Comment Column" of the report.

ALL EXCEPTIONS LISTED UNDER "OE" SHOULD INCLUDE A DETAILED EXPLANATION.

10. "Post Trade Quote" is one of the most widely used exceptions. A standard time-span of 30 seconds should be used by all exchanges. However, ALL orders falling into this category should be flagged as an exception and listed on the daily exception report. Furthermore, the exchanges should keep in mind that many Sub-Committee members have voiced their frustration regarding small orders, that should be executed with virtually no human intervention, falling into this category.

11. "Average Effective Spread" should be a monthly measurement for all classes. Effective Spread for Buy Orders:
2 X (exec. px. - midpoint of consolidated best bid and offer at time of order receipt) Effective Spread for Sell Orders:
2 X (midpoint of consolidated best bid and offer at time of order receipt - exec. px.)

12. "Liquidity Enhancement" statistics should be provided once quote size is widely disseminated. Until such time, we recommend that this not be included as a measurement.

Best Ex Sub-Committee:

Joseph Bagnoli - Waterhouse
Jamie Beamer - Schwab
Joseph Bile - CIBC
Tom Boggs - Knight Trading
Edward Boyle - Letco
Matt Gelber - Fidelity
Rich Gueren - MSDW
Laura Holder - AGE

Jim Knight - Raymond James
Ed Lynn - UBSPW
Beth Malloy - ABN Amro
Harry Maxfield / Frank O'Connor - Brown & Company
Chris Nagy - Advanced Clearing
John Power - Botta Trading
Bill Ryan - SG Cowen
Mark Strauble - DLJ
Stewart Winner - Pru