

Date: April 16, 2001 Regulatory Circular RG 01-49  
To: All Members  
From: Regulatory Services Division  
Re: Basic Market-Making Obligations

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The Division is issuing this circular to summarize rules defining the nature of certain basic market-making obligations, so that there is no confusion about how the Division is enforcing those obligations. Although the Exchange currently is reviewing possible modifications to the rules governing market-making obligations, Members are reminded that they must conform to existing applicable rules unless and until those rules are modified through the rule making process.

**A. Specific Market-Making Obligations under Rule 8.7**

The following specific market-making obligations are derived from Rule 8.7(b) and related rules and apply to market-makers who are physically present at a particular trading station.<sup>1</sup>

1. Rule 8.7(b) describes various conditions that trigger a market-maker's duty to verbalize a market in a particular option series.<sup>2</sup> In general, a market-maker will be presumed to have a duty to verbalize a market in a series if either:
  - a. a DPM, an OBO, an acting OBO or any Exchange member has requested a market in that series from that market-maker; or
  - b. in response to a general request for a market, a market is not then being vocalized in that series by a reasonable number of market-makers.

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<sup>1</sup>DPMs are subject to all of the market-making obligations described in this Circular, in addition to various other requirements specifically applicable to DPMs.

<sup>2</sup>These circumstances are summarized in section B.1 below.

2. When quoting markets, market-makers must verbalize two-sided markets in open outcry (Rule 6.43). Mere hand-raising to indicate one's intention to participate in a trade is not consistent with this open out-cry requirement.
3. When making a market, a market-maker may not exceed the maximum allowable spread differential specified in Rule 8.7(b)(iv) or as otherwise established by Floor Officials or by the appropriate Market Performance Committee.
4. Because a market-maker is obliged to make a two-sided market when responding to a request for a market by a DPM, an OBO, an acting OBO, or any Exchange member, a market-maker who makes only a bid will be deemed to have implicitly made an offer at the maximum allowable spread and will be required to honor the resulting two-sided market. Likewise, a market-maker who verbalizes only an offer will be implied to have made a bid at the maximum allowable spread and will be held to the resulting two-sided market (Rule 8.7, interpretation .06).
5. A market-maker must verbalize all bids and offers in open out-cry and may not direct bids and offers to select individuals. A market-maker may not refuse to trade with any individual who, in response to the market-maker's market, has accepted the bid or offer in open out-cry in accordance with the rules of trading priority (Rule 6.43).
6. A member may request quotes from market-makers ONLY for legitimate market purposes, and not as a means of intimidation or harassment (Rule 4.19).
7. When requested to do so by a DPM, an OBO, an acting OBO, or any Exchange member, a market-maker must trade a minimum of 5 contracts on that market-maker's verbal market if size is not specified, and otherwise must trade at whatever size is specified, regardless of the type of trade or order being represented in the crowd (i.e., whether or not the order is from a customer, firm, market-maker, or non-member broker-dealer) (Rule 8.7, interpretation .05).
8. When requested to do so by a DPM, an OBO, an acting OBO, or any Exchange member in order to help satisfy the crowd's firm quote obligation under Rule 8.51, a market-maker who is physically present in a trading crowd must participate with the crowd on trades at the disseminated quote, even when that market-maker's market is worse than the disseminated market.
9. With respect to orders that are not entitled to an execution under the firm quote rule, but that seek execution at the disseminated market, all market-makers physically present in the trading crowd either must participate with the crowd on such orders when requested to do so or cause or permit the disseminated market to be changed (i.e., a market-maker must "trade or fade" the quote) (Rule 8.51(b)).
10. It is common for non-DPM market-makers to focus their normal trading activity in less than all of the classes in the trading crowd where the market-makers are

physically present. However, even in those classes in which a market-maker does not normally trade, a market-maker who is physically present in a trading crowd must verbalize a market under the circumstances described in paragraph 1 and must participate in trades that are required to honor the crowd's order execution obligations under the firm quote rule when requested to do so by a DPM, an OBO, an acting OBO, or any Exchange member.

## **B. Market-Making Obligations Generally**

The specific market-making obligations described in section A above derive from the general market-making obligations under Rule 8.7(b) as summarized below.

1. These obligations are triggered when any of the following circumstances exist or are reasonably anticipated to exist:
  - i) A lack of price continuity;
  - ii) A temporary disparity between the supply of and demand for a particular option contract; or
  - iii) A temporary distortion of the price relationship between option contracts of the same class.
2. A market-maker must engage in dealings in that person's own account with respect to all series that are subject to the circumstances described in paragraph B.1 and must, among other things:
  - i) Compete with other market-makers to improve markets in those series;
  - ii) Make markets which, absent changed market conditions, will be honored to a reasonable number of contracts in those series; and
  - iii) Update market quotations in response to changed market conditions in those series.