



Regulatory Circular RG 01-150

Date: October 17, 2001

To: Members and Member Firms

From: Regulatory Services Division

Re: Participation Rights for Firms Crossing Orders in Broad-Based Index Options

This Circular addresses provisions for a participation right for firms that wish to facilitate certain customer orders in broad-based index options and options on exchange-traded fund shares derived from broad-based indices (referred to herein collectively as "broad-based index options").

Eligible Orders

Rule 6.74(e), "Crossing" Orders, is only applicable to broad-based index option orders (where the option class is not traded at an equity option trading post) of a size equal to or greater than a size designated by the Index Floor Procedure Committee or the SPX Floor Procedure Committee.¹ The designated size may not be less than 50 contracts. The Index Floor Procedure Committee and the SPX Floor Procedure Committee have initially determined to set the contract limit at 500 contracts for each of the applicable broad-based index options. In the case of a multi-part or spread order, one leg alone of the order must meet the eligible size requirement to qualify.

Originating Firm Guaranteed Participation

- **20% if traded at or between the crowd's market.**

Rule 6.74(e) entitles the floor broker, under certain circumstances, to cross a specified percentage of the original order on behalf of the originating firm, with a facilitation order of the originating firm, before market makers in the crowd can participate in the transaction. If the orders are crossed at or between the crowd's initial bid or offer the floor broker will be entitled to cross at least 20% of the original order. The floor broker may cross more than this percentage entitlement if the other members of the trading crowd do not choose to trade against the remainder of the order.

For What Period is the Crowd's Market Effective

¹ The broad-based index options currently not traded at equity option trading posts include Standard & Poor's 100 Stock Index options ("OEX", "XEO"), iShares S&P 100 Index Fund ("OEF"), Standard & Poor's 500 Stock Index options ("SPX"), Nasdaq 100 Stock Index options ("NDX"), Nasdaq 100 Index Trading Stock (QQQ), CBOE Mini-NDX ("MNX") and options on the Dow Jones Industrial Average ("DJX"). Determination of the eligible order size requirement in OEX, XEO, NDX, QQQ, MNX, DJX and OEF is the responsibility of the Index Floor Procedure Committee.

Once a trading crowd has provided a market in response to the floor broker's initial request for a market in connection with an order the firm wished to cross, the market will remain in effect until (a) a reasonable amount of time has passed; (b) a significant change has occurred in the price of the underlying index of the option; or (c) the facilitation market given in response to the request is improved. In the case of a dispute, "significant change" will be determined on a case-by-case basis by two Floor Officials, based upon the extent of recent trading in the option and the underlying index and any other relevant factors.

DPM Participation Entitlement

- **DPM guarantee only applies at the DPM's bid or offer. Together with the firm guarantee cannot exceed 40% of the amount remaining after public customer orders are traded.**²

Once any public customer orders have been filled and the originating firm has taken its percentage entitlement, the Designated Primary Market-Maker ("DPM") at the particular trading station is entitled to take its percentage entitlement on the balance but only if the order is crossed at the DPM's principal bid or offer.³ If the order is crossed between the crowd's best bid or offer the DPM is not entitled to its percentage entitlement. The percentage that the DPM will receive is determined by reference to the established DPM participation rate - subject to limitation. The DPM's guaranteed participation may not be greater than that provided for pursuant to the Exchange's rules. If the floor broker crosses the full 20% of the originating firm's entitlement (or greater), the number of contracts guaranteed to the DPM may not exceed 25% of the remainder of the order after the originating firm has taken its share. If the floor broker does not cross 20%, the DPM may be entitled to more, but in no case may the DPM be *guaranteed* a percentage that, when combined with the percentage of the firm's *guarantee* that is taken, exceeds 40% of the original order (after relevant public customer orders have been satisfied). Again, as with the firm's guaranteed percentage, the DPM may take more than his guaranteed participation if the other members of the trading crowd do not choose to trade against the remainder of the order.

Priority of Other Participants

As to the priority of other participants, the rule provides that the members of the trading crowd who establish the market in response to the floor broker's initial request will have priority over all other orders that were not represented in the crowd at the time that market was established, except for orders that improve upon those quotes. Further, a floor broker holding a customer order and a facilitation order and who makes a request for a market will be deemed to be representing both the customer order and the facilitation order, so that the customer order and the facilitation order will also have priority over all other orders that were not being represented in the trading crowd at the time the market was established.

Examples

At the bid or offer

Assume a floor broker has a customer order to buy 1000 contracts in the September MNX option class with a strike price of 360. The floor broker will ask the crowd for a market in this MNX series.⁴ Assume the best

² Currently, MNX, NDX and QQQ are the only applicable broad-based index option classes that have been assigned a DPM.

³ If the same member organization is both the originating firm and the DPM for the class of options in which the transaction takes place, and the floor broker acting on behalf of the firm takes advantage of the crossing right provided by the rule, the firm will not be entitled to any participation in the trade based on the guaranteed percentage ordinarily granted to DPMs pursuant to CBOE Rule 8.87.

⁴ As is the case with facilitation crosses, the facilitating firm is required to disclose on the order ticket for the public customer order all terms of the order, including any contingency involving, and all related transactions in, either options or underlying or related securities. The floor broker is required to disclose all securities that are components of the public customer order before requesting bids and offers for the execution of all components of the order.

market provided by the crowd in response to this initial request is 5 (bid) – 5.25 (offer). Also, assume the DPM for MNX is at the crowd's market. Now, assume the broker leaves the crowd for a short period of time, during which the market remains in effect. During this short period of time away from the crowd, the floor broker determines to trade the original customer order against a facilitation order at the crowd's market of 5.25. Also, assume that there is a public customer order for 200 contracts in the book to sell at 5.25. Under this scenario, the public customer order in the book would trade against the first 200 contracts of the 1000 lot original order. The firm would then be entitled to take its 20% percentage entitlement on the remaining 800 contracts, or 160 contracts. The DPM would then be entitled to take 25% of the remainder of 640 contracts, or 160 contracts. The other members of the trading crowd would then be entitled to trade the other 480 contracts pursuant to the normal priority rules. To the extent the other members of the trading crowd determined not to trade against all of the remaining 480 contracts, the firm and the DPM would have the opportunity to trade against the balance.

Between the bid and offer

In the same example, if the floor broker determined to facilitate the order at a price of 5.10, the firm would still only be able to trade 20% of the remaining 800 contracts, or 160 contracts, but the DPM would not be entitled to any specific percentage guarantee because the trade price improved upon the DPM's principal bid or offer. The DPM would, however, have the opportunity to compete for the remaining 640 contracts with the other members of the trading crowd.

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Please be advised that any violation of the guaranteed participation provisions of the crossing rule may be referred to the Business Conduct Committee for appropriate disciplinary action.

Questions concerning this circular may be directed to Jaime Galvan, Legal Division at (312) 786-7058 or Pat Cerny, Department of Market Regulation at (312) 786-7722.

Regulatory Circular RG 01-150 replaces Regulatory Circular RG 00-123.
