

Date: May 16, 2003

Regulatory Circular #03-35

To: Members and Member Firms

From: Floor Directors

Re: Payment for Order Flow

The Exchange's Board of Directors has determined to reinstitute a marketing fee for the purpose of facilitating payment for order flow. The decision of the Board to reinstitute a marketing fee is based upon the absence of regulatory action to prohibit payment for order flow and in recognition of the competitive forces within the options industry which require such a fee so that the Exchange can remain competitive.

The program, which differs significantly from the program that was in place at CBOE from July 2000 to August 2001, will operate as follows:

- A five person Oversight Committee consisting of 4 market makers (3 of which are not associated with a DPM) and 1 DPM representative, will determine all administrative procedures pertaining to the program in accordance with the rules.
- The program will become effective beginning Monday, June 2, 2003 for a minimum of 90 calendar days in all trading crowds where the DPM has determined to engage in payment for order flow.
- DPMs will be solely responsible for negotiating with firms any payment for order flow arrangements for the option classes assigned to them.
- Only customer orders of 200 contracts or less, originating from payment-accepting firms, are eligible for the program.
- DPMs and Market Makers will be charged \$.40 per contract only when they trade against eligible orders received from payment-accepting firms.
- If a DPM has negotiated a payment to a firm in excess of \$.40 per contract, any cost beyond \$.40 per contract will be the financial responsibility of the DPM.
- In the event that a DPM has negotiated a payment of less than \$.40 per contract, the difference between \$.40 and the actual payment will be returned to the DPM and/or Market Makers.

(over)

- The \$.40 fee will be electronically drafted from the appropriate DPM and/or Market Maker's account and credited to the account of the appropriate order-sending firm. (i.e. there will be no pools created as in the old program)

Voting Procedures

- After 90 calendar days each crowd may choose to terminate or continue participation in the program by means of an in-crowd vote to be conducted as follows:
 - i. Members of a trading crowd eligible to participate in the vote will include the DPM and those Market Makers who have transacted at least 80% of their market maker contracts and transactions in-person in each of the three immediately preceding calendar months in option classes traded in the trading crowd, and who continue to be members of the trading crowd in the capacity of a Market Maker at the time of the vote.
 - ii. Members of a crowd who are absent at the time of the vote may vote by written and signed proxy. Eligible Market Makers have one vote. The DPM organization operating in that crowd will have only one vote, regardless of the number of DPM designees in the crowd.
 - iii. A trading crowd will be deemed to have indicated that it will cease to participate in the payment program if a majority of the eligible members of the trading crowd participate in the vote and if a majority of the total votes cast is in favor of terminating the program. If a crowd determines to cease participation, another vote may not be called for 30 calendar days.
 - iv. A trading crowd will be deemed to have indicated that it will reinstate a program that has been discontinued if a majority of eligible members participate in the vote and if a majority of the total votes cast is in favor of reinstating the program. If a crowd determines to reinstate participation, another vote may not be called for 90 calendar days.
 - v. In the event of a tie vote, no change will occur (i.e. if the plan is in place, it will remain in place, and if the plan has been discontinued, it will remain discontinued).
 - vi. The Exchange will post a notice at the trading station at least 10 calendar days prior to the time of the vote and ballots will be in written form.
 - vii. DPMs must disclose the identity of the firms they propose to pay. The list of firms must be presented to the crowd seven calendar days prior to the vote and the list will also be printed on the ballot used during the crowd voting procedure.
 - viii. The identity of any and all members requesting to schedule a vote will be held anonymous with the Secretary of the Exchange who is responsible for determining if such member(s) is/are eligible to request a vote in a certain crowd.

Any questions concerning the operation of the program or requests for copies of the rules regarding the program should be directed to Daniel Hustad at 312-786-7715 or Edward Provost at 312-786-7717.