



Regulatory Circular RG05-116

DATE: November 22, 2005

TO: Members and Member Firms

FROM: Legal Division
Regulatory Division
Trading Operations Division

RE: DPM Obligations Until the Implementation of
the PAR Official Program

On November 18, 2005, the Securities and Exchange Commission ("SEC") approved a CBOE rule change, SR-CBOE-2005-46 ("rule change" or "PAR Official rule change"), that, among other things, (1) prohibits a DPM from executing orders as an agent or Floor Broker in its allocated option classes and (2) eliminates the authority of a DPM to act in any other way as a Floor Broker in those classes.¹ Rule 8.8 and Rule 8.85(b) now prevent a DPM from representing or executing orders for other persons in the DPM's assigned option classes. Once the rule change goes into effect in a particular options class, the DPM assigned to that option class will lose the ability to take custody of or handle orders for other persons in that option class, including through operation of the PAR terminal. The rule change authorizes the Exchange to assign to an Exchange employee or subcontractor known as a PAR Official, the responsibility, among other things, to operate the PAR workstation for designated option classes, to maintain the book in those classes, to represent orders to be sent via Intermarket Option Linkage in those classes, and to effect executions of agency orders placed with the PAR Official in those classes.

The rule change allows the Exchange to put PAR Officials in place in DPM trading crowds during a 90-day period after the SEC approves the rule change. This provision is intended to insure a smooth roll-out of the PAR Official program. Therefore, until a PAR Official is put in place in a particular DPM trading crowd during this 90-day transition period, the DPM in that trading crowd will continue to be responsible to operate the PAR workstation and will continue to be subject to the same agency obligations as set forth under former Rule 8.85(b) and to other obligations applicable to

¹ Please refer to the rule change and the SEC order approving the rule change, which both can be found on the Exchange's website at <http://www.cboe.org/Legal/filings.aspx>.

DPMs under current and former Exchange rules. These rules and regulations are provided below:

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DPM Obligations

(a) **General Obligations.** Each DPM shall fulfill all of the obligations of a Floor Broker or Order Book Official (to the extent that the DPM acts as a Floor Broker) under the Rules, and shall satisfy each of the requirements contained in this paragraph, in respect of each of the securities allocated to the DPM. To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b) through (i) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b) through (i) of this Rule shall govern.

(b) **Display Obligation:** Each DPM shall display immediately the full price and size of any customer limit order that improves the price or increases the size of the best disseminated CBOE quote. "Immediately" means, under normal market conditions, as soon as practicable but no later than 30-seconds after receipt ("30-second standard") by the DPM. The term "customer limit order" means an order to buy or sell a listed option at a specified price that is not for the account of either a broker or dealer; provided, however, that the term customer limit order shall include an order transmitted by a broker or dealer on behalf of a customer. The following are exempt from the Display Obligation as set forth under this provision:

(A) An order executed upon receipt;

(B) An order where the customer who placed it requests that it not be displayed, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were subject to being displayed;

(C) An order for which immediately upon receipt a related order for the principal account of a DPM reflecting the terms of the customer order is routed to another options exchange that is a participant in the Intermarket Options Linkage Plan;

(D) The following orders as defined in Rule 6.53: contingency orders; one-cancels-the-other orders; all or none orders; fill or kill orders; immediate or cancel orders; complex orders (e.g., spreads, straddles, combinations); and stock-option orders;

(E) Orders received before or during a trading rotation (as defined in Rule 6.2, 6.2A, and 6.2B), including Opening Rotation Orders as defined in Rule 6.53(l), are exempt from the 30-second standard, however, they must be displayed immediately upon conclusion of the applicable rotation; and

(F) Large Sized Orders: Orders for more than 100 contracts, unless the customer placing such order requests that the order be displayed.

(c) A DPM shall not remove from the public order book any order placed in the book unless (A) the order is canceled, expires, or is executed or (B) the DPM returns the order to the member that placed the order with the DPM in response to a request from that member to return the order;

(d) A DPM shall accord priority to any customer order which the DPM represents as agent over the DPM's principal transactions, unless the customer who placed the order has consented to not being accorded such priority;

(e) A DPM shall not charge any brokerage commission with respect to:

(1) the execution of any portion of an order for which the DPM has acted as both agent and principal, unless the customer who placed the order has consented to paying a brokerage commission to the DPM with respect to the DPM's execution of the order while acting as both agent and principal; or

(2) any portion of an order for which the DPM was not the executing floor broker, including any portion of the order that is automatically executed through an Exchange system; or

(3) any portion of an order that is automatically cancelled, or;

(4) any portion of an order that is not executed and not cancelled.

(f) A DPM shall act as a Floor Broker to the extent required by the MTS Committee.

(g) A DPM shall not represent discretionary orders as a Floor Broker or otherwise.

(h) *Autobook Pilot.* A DPM shall maintain and keep active on the DPM's PAR workstation at all times the automated limit order display facility ("Autobook") provided by the Exchange. The appropriate Exchange Floor Procedure Committee will determine the Autobook timer in all classes under that Committee's jurisdiction. A DPM may deactivate Autobook as to a class or classes provided that Floor Official approval is obtained. The DPM must obtain such approval no later than three minutes after deactivation.

(i) The Exchange may make personnel available to assist a DPM in the DPM's performance of the obligations of an Order Book Official, for which the Exchange may charge the DPM a reasonable fee.

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RAES Operations

DPMs will still be responsible for non-automated handling of orders routed to the PAR workstation pursuant to Rule 6.8(d)(vi) and Interpretation and Policy .02(b) of Rule 6.8.

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Priority of Bids and Offers and Priority of Allocation of Trades

DPMs shall be required to comply with those provisions of Rule 6.45, 6.45A, and 6.45B, that are now assigned to PAR Officials.

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Timing of Firm Quote Obligations in a DPM Trading Crowd With Respect to Firm Disseminated Market Quotes

In Non-Hybrid classes, for purposes of determining when the firm quote obligations under Rule 8.51 attach in respect of orders received at a PAR workstation in a DPM trading crowd and how the exemptions to that obligation provided in paragraph (e) of that Rule apply, the responsible broker or dealer shall be deemed to receive an order, and an order shall be deemed to be presented to the responsible broker or dealer, at the time the order is received on the DPM's PAR workstation.

In Hybrid classes, for purposes of determining when the firm quote obligations under Rule 8.51 attach with respect to orders received at a PAR workstation in a DPM trading crowd and how the exemptions to that obligation provided in paragraph (e) of that rule apply, the responsible broker or dealer shall be deemed to receive an order, and an order shall be deemed presented to the responsible broker or dealer:

- (i) at the time the order is announced to the trading crowd with respect to each responsible broker or dealer that is not the DPM for the class; and
- (ii) at the time the order is received on PAR with respect to the DPM as the responsible broker or dealer.

As such, firm quote obligations for an order received on a PAR workstation may attach at two separate times for different responsible broker or dealers: at the time of receipt with respect to the DPM as a responsible broker or dealer and at the time of announcement with respect to non-DPM members of the trading crowd as responsible brokers or dealers.

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Linkage Rules

Only with respect to any DPM continuing to represent and execute orders as agent pursuant to this Regulatory Circular, Rule 6.80 ("Definitions") paragraph (12)(i) shall read as follows:

"Principal Acting as Agent ('P/A') Order," which is an order for the principal account of a Market-Maker (or equivalent entity on another Participant Exchange that is authorized to represent Customer orders) reflecting the terms of a related unexecuted Customer order for which the Market-Maker is acting as agent.

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DPM Designees

The DPM must continue to maintain the requisite number of approved DPM Designees, as defined under Rule 8.81. Additionally, these DPM Designees must continue to be registered as a Floor Broker pursuant to Rule 6.71. A DPM Designee also shall continue to be restricted from trading as a Floor Broker in securities allocated to the DPM unless acting on behalf of the DPM in its capacity as a DPM.

Finally, when acting on behalf of a DPM in its capacity as a DPM, the DPM Designee is exempt from the provisions of Rule 8.8 ("Restriction on Acting as Market-Maker and Floor Broker"). (See former Rule 8.81(e)).

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Rule 17.50. Imposition of Fines for Minor Rule Violations

DPMs shall be subject to a fine for failure to promptly book and display limit orders that would improve the disseminated quote or for failure to use due diligence in the execution of orders for which the DPM maintains an agency obligation.

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Summary

After the rule change has been approved and until the end of the 90-day period, neither a DPM assigned to a trading crowd nor the Exchange shall be subject to the provisions of the rule change with respect to the operation of that trading crowd until a PAR Official has been assigned to that trading crowd.

Questions pertaining to this Regulatory Circular should be directed to Jim Flynn at (312) 786-7070; Doug Beck at (312) 786-7959; or John Johnston at (312) 786-7303.