



## Regulatory Circular RG05-117

**DATE:** November 22, 2005

**TO:** Members and Member Firms

**FROM:** Legal Division  
Regulatory Division  
Trading Operations Division

**RE:** Separation of DPM Agency and Principal Functions

On November 18, 2005, the Securities and Exchange Commission ("SEC") approved a CBOE proposed rule change (SR-CBOE-2005-46) that, among other things, prohibits a DPM from executing orders as an agent in its allocated option classes, a function DPMs were allowed and obligated to perform under CBOE Rules prior to the rule change. Please visit the CBOE website at <http://www.cboe.org/Legal> to review the proposed rule change and the corresponding SEC approval order. With the approval of this rule change, existing Rules 8.8 and 6.70 now prevent DPMs from accepting or executing orders from any source. The rule change also authorizes the Exchange to hire and appoint an Exchange employee or subcontractor, known as a PAR Official, to each DPM trading crowd, and these PAR Officials are to assume responsibility for many of the functions and obligations that DPM PAR brokers performed under Exchange Rules prior to the rule change. This circular outlines the significant aspects of the rule change and addresses the DPMs' obligations and limitations.

1. **ROLLOUT:** The Exchange shall have 90 days from November 18, 2005, to put PAR Officials in place in the trading crowds to which a DPM is appointed. This rule change shall not affect trading crowds or option classes in which no DPM is appointed. However, the Exchange may consider appointing a PAR Official or a comparable individual(s) to handle linkage orders in non-DPM trading crowds that trade option classes that are multiply listed.
2. **PAR OFFICIAL STATUS:** Each PAR Official shall be an Exchange employee or independent contractor whom the Exchange may designate as being responsible for (i) operating the PAR workstation in a DPM trading crowd with respect to the classes of options assigned to him/her; (ii) when applicable, maintaining the book with respect to the classes of options assigned to him/her;<sup>1</sup> and (iii) effecting proper executions of orders placed with him/her.

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<sup>1</sup> This will not apply to Hybrid classes.

For a complete list of PAR Official functions and obligations, please refer to the proposed rule change at the locations provided above.

3. **NUMBER OF PAR OFFICIALS:** A single PAR Official may be assigned to more than one DPM trading crowd, and some DPM trading crowds may be assigned two PAR Officials. Although the Exchange alone shall be responsible for assigning each individual PAR Official to the respective trading crowd(s), all efforts will be made to ensure that the quality of service provided in each options class is not affected.

4. **DPM RESTRICTION ON REPRESENTING AND EXECUTING AGENCY ORDERS:** Under the rule change, a DPM may not execute orders as an agent in its allocated securities. Accordingly, DPMs shall become subject to Rule 8.8, which shall prevent them from acting as a Floor Broker in options traded at their station. Under Rule 6.70(a), this means that DPMs shall not any longer be able to accept orders from any other persons, much less execute such orders. In other words, the effect of the proposed rule is to prohibit DPMs from taking custody of another person's order or from acting on behalf of another person with respect to that person's order, whether or not the DPM participates on the order as principal. This prohibition shall include taking custody of another person's order for even a brief period of time or acting as a conduit to pass an order on to another person for handling. Such conduct would violate proposed Rule 8.85(b) and thereby would violate existing Rule 8.8. Moreover, a principal trade that steps ahead of an order over which the DPM has custody at the time of the principal trade – however brief the time interval during which the order was in the DPM's custody – would subject the DPM to liability for trading ahead of that order.

The Exchange understands that, in the course of business, DPMs may be expected to respond to telephone inquiries from customers or brokers about whether the trading crowd is willing to trade at a particular price in a stated quantity. Performing the following functions in response to such inquiries shall not cause the DPM to be deemed to be functioning as an agent or Floor Broker:

- (i) canvassing the trading crowd to determine which participants are prepared to trade at a certain price and in what quantities;
- (ii) disclosing the quantity at which the DPM and the trading crowd as a whole are prepared to trade; and
- (iii) informing the customer or broker that the trading crowd is willing to trade at that price and quantity and to provide a firm quote for a single bid (offer) on behalf of the DPM and the trading crowd.

Any such communications over telephone lines may be subject to Rule 6.23 and applicable CBOE telephone policies. In addition, any request for, and providing of, a firm single bid (offer) quote must comply with Interpretation .11 of Rule 8.7.

If the DPM has communicated directly to a customer the price and quantity at which the DPM and the trading crowd are prepared to trade, the customer must submit any resulting order through a CBOE broker, and may not submit that order directly to the DPM or to the PAR Official. When a CBOE broker is the party contacting the DPM for the purpose of determining the potential interest for a particular order, the broker must systematize any resulting order for the purposes of COATS compliance, announce the order to the crowd (if a verbal order), and effect the actual execution of the order.

It should be noted that it is not possible to illustrate every possible scenario in which a DPM may or may not be deemed to be an agent for an order. This regulatory circular is intended only to provide general guidance on how certain types of customer orders shall be handled after the implementation of the PAR Official program. DPMs are responsible for determining whether certain actions or practices are appropriate.

**5. LIMITATION ON EXECUTING CERTAIN TYPES OF ORDERS:** The PAR Official shall be authorized to execute the same types of orders that DPM brokers currently execute. Note that PAR Officials shall not be allowed to handle “not held” orders.

**6. LINKAGE FUNCTIONS AND OBLIGATIONS:** As provided in the proposed rule change, in connection with the performance of the PAR Official’s Linkage functions, the following shall apply:

- a. The PAR Official shall be responsible for manually or automatically (1) routing, through the DPM’s account, linkage Principal Acting as Agent (“P/A”) Orders, Principal (“P”) Orders on behalf of orders in the custody of the PAR Official that are for the account of a broker-dealer (“P-BD Orders”), and Satisfaction Orders to other markets based on prior written instructions that must be provided by the DPM to the PAR Official; and (2) handling all linkage orders or portions of linkage orders received by the Exchange that are not automatically executed.
- b. When handling outbound P/A Orders, P-BD Orders and Satisfaction Orders, the PAR Official shall use due diligence to execute the orders entrusted to him/her and shall act in accordance with the prior written instructions provided by the DPM for P/A Orders, P-BD Orders, and Satisfaction Orders that the PAR Official represents.
- c. A PAR Official also shall act in accordance with CBOE rules regarding P/A, P, and Satisfaction Orders received through the Linkage.
- d. A PAR Official shall be responsible for diligently handling all linkage orders or portions of linkage orders received by the Exchange that are not automatically executed.

The DPM shall not be deemed the agent simply because the DPM's account is being used to facilitate these Linkage orders.

7. **COMPENSATION AND LIMITATION ON AFFILIATIONS:** The PAR Official shall be compensated exclusively by the Exchange, which shall determine the amount and form of compensation for each PAR Official. No DPM, e-DPM, or Market-Maker shall directly or indirectly compensate or provide any other form of consideration to a PAR Official. The PAR Official may not be affiliated with any member that is approved to act as a Market-Maker.

8. **EXECUTION BILLING:** Currently, the Exchange does not intend to charge brokerage fees for executions performed by a PAR Official for any member firm.

9. **PAR OFFICIAL ERRORS:** Errors committed solely by PAR Officials shall be resolved in the same manner as errors committed by OBOs on the Exchange.

10. **EXCHANGE LIABILITY FOR ACTIONS OF PAR OFFICIALS:** The Exchange's liability to members or persons associated therewith for any loss, expense, damages or claims arising out of any errors or omissions of an PAR Official or any persons providing assistance to a PAR Official shall be subject to Exchange rules, including the limitations set forth in Rule 6.7, Rule 6.7A, and Rule 7.11. Refer to the Exchange website for the full text of these rules.

The Exchange will update the membership should any new developments arise. Please direct any questions or comments to Doug Beck at (312) 786-7959, Ed Barry at (312) 786-8727, or Jim Flynn at (312) 786-7070.