



To: Membership

Regulatory Circular RG05-94

From: Legal Division

Date: October 14, 2005

Re: Preferred Market-Maker Program

The SEC has approved expansion of the Exchange's Preferred Program for directed orders (the program is operating on a pilot basis until June 2, 2006). Under the expanded program, an order provider may designate *any* Exchange Market-Maker type (including DPMs, e-DPMs, Market-Makers, Remote Market-Makers, Lead Market-Makers etc.) in any designated Hybrid class as the "Preferred Market-Maker" for orders sent to the Exchange (use of the Preferred designation is optional).¹

Formerly only the DPM or e-DPMs in a particular option class were eligible for the "Preferred" designation in such class. Under the revised rule, the "Preferred" designation is now open to any Exchange Market-Maker type provided such Market-Makers comply with all applicable existing quoting obligations under Exchange rules *and* provide continuous two-sided quotations in at least 90% of the series of each class for which it receives Preferred Market-Maker orders.

If the Preferred Market-Maker is quoting at the NBBO at the time the order is received and executed electronically by the Hybrid System, the Preferred Market-Maker will receive a 40% participation entitlement.² If the Preferred Market-Maker is not quoting at the NBBO, then the order shall be handled/executed in accordance with existing processes, which may include use of the standard DPM Complex participation entitlement provided in Rule 8.87. Please note the participation entitlement is based on the number of contracts remaining after all public customer orders in the book at the best bid/offer on the Exchange have been satisfied, and that in no case shall a Market-Maker be allocated a total quantity greater than the quantity that the Market-Maker is quoting at the best bid/offer on the Exchange. Further, be advised that Exchange Rule 4.18's prohibition of the misuse of material non-public information also applies to the Preferred Market-Maker program.

Members that are interested in having orders directed to them as a Preferred Market-Maker must register with the Exchange by completing the attached form and submitting it to the 4th Floor Help Desk. Help Desk staff will then contact the participant prior to making the necessary enablements and will e-mail a confirmation after the enablements are made. Please note that DPMs and e-DPMs that wish to continue receiving directed orders must also complete and submit the attached form by October 31, 2005.

The text of the current Preferred Market-Maker Program Rule is below. Questions regarding this circular should be addressed to Angelo Evangelou, Legal Division, at (312) 786-7464; operational questions regarding establishing the ability to receive Preferred orders should be addressed to Anthony Montesano, Trading Operations, at (312) 786-7365.

¹ See Information Circular 05-71 for technical information regarding transmission of Preferred orders.

² The Preferred participation entitlement rate is 50% when there is only one other Market-Maker also quoting at the best price.

Rule 8.13 Preferred Market-Maker Program

(a) *Generally.* The Exchange may allow, on a class-by-class basis, for the receipt of marketable orders, through the Exchange's Order Routing System when the Exchange's disseminated quote is the NBBO, that carry a designation from the member transmitting the order that specifies a Market-Maker in that class as the "Preferred Market-Maker" for that order. A qualifying recipient of a Preferred Market-Maker order shall be afforded a participation entitlement as set forth in subparagraph (c) below. The Preferred Market-Maker Program shall be in effect until June 2, 2006 on a pilot basis.

(b) *Eligibility.* Any Exchange Market-Maker type (e.g. Remote Market-Maker, Lead Market-Maker, and Designated Primary Market-Maker) may be designated as a Preferred Market-Maker, however, a recipient of a Preferred Market-Maker order will only receive a participation entitlement for such order if the following provisions are met:

- (i) The Preferred Market-Maker must have an appointment/allocation in the relevant option class.
- (ii) The Preferred Market-Maker must be quoting at the best bid/offer on the Exchange.
- (iii) The Preferred Market-Maker must comply with the quoting obligations applicable to its Market-Maker type under Exchange rules and must provide continuous two-sided quotations in at least 90% of the series of each class for which it receives Preferred Market Maker orders.

(c) *Entitlement Rate.* Provided the provisions of subparagraph (b) above have been met, the Preferred Market-Maker participation entitlement shall be 40% when there are two or more Market-Makers also quoting at the best bid/offer on the Exchange, and 50% when there is only one other Market-Maker quoting at the best bid/offer on the Exchange. In addition, the following shall apply:

- (i) A Preferred Market-Maker may not be allocated a total quantity greater than the quantity that the Preferred Market-Maker is quoting at the best bid/offer on the Exchange.
- (ii) The participation entitlement rate is based on the number of contracts remaining after all public customer orders in the book at the best bid/offer on the Exchange have been satisfied.
- (iii) If a Preferred Market-Maker receives a participation entitlement under this Rule, then no other participation entitlements set forth in Exchange Rules (e.g. Rule 8.87 Participation Entitlement of DPMs and e-DPMs and Rule 8.15B Participation Entitlement of LMMs) shall apply to such order.

APPLICATION FOR PREFERRED MARKET-MAKER DESIGNATION

Please enable the following Members to receive orders designating a Preferred Market-Maker:

Name: _____ Acronym: _____

Name: _____ Acronym: _____

Name: _____ Acronym: _____

Name: _____ Acronym: _____

Name: _____ Acronym: _____

The Member and/or Member Firm has procedures in place to ensure that the Member will meet the eligibility requirements in Rule 8.13(b) while enabled to receive an order specifying a Preferred Market-Maker. Absent reasonable justification, a Market-Maker (including any Exchange Market-Maker type) who fails to meet the eligibility requirements will be subject to disciplinary action. The Member Firm may also be subject to disciplinary action if the CBOE finds a pattern or practice of activity in violation of the eligibility requirements set forth in Rule 8.13(b).

If the Member and/or Member Firm wishes to revoke this authorization for a Market-Maker to receive orders specifying a Preferred Market-Maker, written notice must be provided via email to the CBOE Help Desk at helpdesk@cboe.com.

Please note that Members and/or Member Firms may be acting in violation of CBOE Rule 4.1 and Rule 4.18 if they participate in inappropriate conversations prior to the submission and/or receipt of an order specifying a Preferred Market-Maker.

Member Firm Name (if applicable): _____

Exchange Market-Maker Type (i.e. MM, DPM, e-DPM, RMM, etc.): _____

By*: _____

Title*: _____

Contact Name: _____

Contact Phone Number: _____

Contact Email Address: _____

Date: _____

* This form must be signed by an officer or general partner of a Member Firm if completed on behalf of a Nominee and/or CBT R.F.

The completed form (with an original signature) should be submitted to the 4th Floor Help Desk for processing.