



Regulatory Circular RG06-118

To: Members  
From: Legal Division  
Date: December 18, 2006  
Re: Rule Change Regarding Open Outcry Crossing Priority (REVISED)

A rule change that amends CBOE Rule 6.74, *Crossing Orders*, has recently become effective (see Release 34-54726; SR-CBOE-2006-89). Rule 6.74 is an open outcry crossing rule that was adopted prior to the time that CBOE established the Hybrid Trading System, which, among other things, introduced dynamic quotes and the ability for non-public customer orders to be placed in the electronic book. The rule change updated Rule 6.74 to (i) clarify the priority of in-crowd market participants ("ICMPs")<sup>1</sup> and these electronic trading interests when crossing orders in open outcry, and (ii) clarify the applicability of Section 11(a)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") to crossing transactions.

**It should be noted that the rule change pertains only to open outcry crossing priority. The open outcry priority rules applicable to non-crossing transactions, which are described in Rules 6.45, 6.45A and 6.45B, have not changed.**

With respect to open outcry crossing priority, the rule change provides the following:

- Crossing Priority Generally: For purposes of establishing priority for bids and offers under the various open outcry crossing procedures described in Rule 6.74, the rule change clarifies that, at the same price, generally: (i) bids and offers of ICMPs have first priority to trade in a crossing transaction (except as otherwise provided in the Rule with respect to public customer orders resting in the electronic book); and (ii) all other bids and offers, including bids and offers of broker-dealer orders in the electronic book and electronic quotes of Market-Makers, have second priority to trade in a crossing transaction.
- Crossing Priority under Rule 6.74(d): Rule 6.74(d) describes the procedures for crossing eligible orders when a Floor Broker is seeking a crossing participation entitlement. The rule change clarifies how the remaining balance of an order will be allocated among the trading crowd after public customer orders in the book, the crossing participation entitlement and any DPM/LMM participation entitlement (if applicable) have been satisfied. The rule change provides that the remaining balance will be allocated among ICMPs who established the market.<sup>2</sup> Broker-dealer orders resting in the book and electronic quotes are not entitled to

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<sup>1</sup> The term "ICMP" only includes an in-crowd Market-Maker, in-crowd DPM or LMM, and Floor Broker or PAR Official representing orders in the trading crowd.

<sup>2</sup> The rule change also clarifies that the balance is allocated among bids (offers) made by ICMPs in the sequence in which they are made. If bids (offers) were made at the same time, or in the event that the sequence is cannot be determined, priority shall be apportioned equally among the ICMPs who

participate if there is sufficient interest among the ICMPs in the trading crowd at the same price or better. However, to the extent there is any remaining balance for which there is not sufficient interest among the ICMPs, same-priced broker-dealer orders resting in the book and electronic quotes would have priority to trade next.

11(a) & “G” Exemption Requirements: Section 11(a)(1) of the Exchange Act restricts securities transactions of a member of any national securities exchange effected on that exchange for (i) the member’s own account, (ii) the account of a person associated with the member, or (iii) an account over which the member or a person associated with the member exercises discretion unless a specific exemption is available, such as transactions by broker dealers acting in the capacity of a market maker and other exemptions. The rule change makes clear that members must ensure that they qualify for an exemption from Section 11(a)(1) when participating in an open outcry crossing transaction. The rule change also addresses the priority of members that are relying on Section 11(a)(1)(G) of the Exchange Act and Rule 11a1-1(T) thereunder (commonly referred to as the “G” exemption) as an exemption. The “G” exemption requires a member to, among other things, yield priority to non-members.<sup>3</sup> Because CBOE’s electronic book does not distinguish between member and non-member broker-dealer orders, the rule change clarifies that members relying on the “G” exemption must yield priority to any same-priced bid or offer of public customer orders and broker-dealer orders resting in the electronic book, as well as any other bids and offers that have priority over those broker-dealer orders under the Rule.<sup>4</sup>

Members seeking further information regarding the open outcry crossing procedures should refer to the rule change, which is available on CBOE’s website at [www.cboe.org/Legal](http://www.cboe.org/Legal). For additional information on the applicable crossing participation entitlements and Section 11(a)(1) requirements, please refer to Regulatory Circulars RG06-83 and RG05-102, respectively. For any other questions, please contact Jennifer Lamie, Legal Division, at (312) 786-7576.

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established the market. In the event an ICMP declines to accept any portion of the available contracts, any remaining contracts shall be apportioned equally among the other ICMPs who established the market until all contracts have been apportioned. However, nothing prohibits a Floor Broker or DPM/LMM from trading more than their applicable participation percentage entitlement if other ICMPs do not choose to trade the remaining portion of the order.

<sup>3</sup> A member relying on the “G” exemption must, among other requirements, yield priority to any bid or offer at the same price for the account of a person who is not, or is not associated with, a member (a “non-member”), irrespective of the size of any such bid or offer or the time when it is entered.

<sup>4</sup> Thus, for example, assume that a Floor Broker is relying on the “G” exemption and asserting a crossing participation entitlement for his proprietary order pursuant to Rule 6.74(d). The Floor Broker would have to yield priority to same priced public customer orders resting in the book, the DPM/LMM (to the extent a participation entitlement applies), ICMPs (to the extent each ICMP is not also relying on the “G” exemption), and broker-dealer orders resting in the book. After yielding, the Floor Broker would have priority to trade (along with any other ICMPs also relying in the “G” exemption) and can assert his crossing participation entitlement. The Floor Broker’s entitlement to the remaining balance of the original order, when combined with the applicable DPM/LMM participation entitlement, shall not exceed 40% of the order. Again, however, provided the “G” exemption requirements are satisfied, nothing prohibits a Floor Broker or DPM/LMM from trading more than their applicable percentage entitlement if other ICMPs do not choose to trade the remaining portion of the order. To the extent there may be any further remaining balance, same-priced electronic quotes of Market-Makers would have priority to trade next.