

Regulatory Circular RG97-80

Date: June 25, 1997
From: Operations Planning Division
To: Membership
Re: Obligations of Competing Market-Makers

It is well recognized, both within and without the Exchange, that the Exchange owes much of its success to its unique competing market maker system and the vigorous competition among market makers that characterizes its marketplace. Because competition among market makers is so important in providing the deep and liquid markets that both retail and institutional investors rely upon for the efficient execution of their orders, all members must clearly understand exactly what are the obligations of market makers to make competing markets in securities listed and traded on the Exchange.

The starting point for understanding the obligations of Exchange market makers is Rule 8.7, "Obligations of Market Makers". With specific reference to a market maker's obligation to make and honor markets, paragraph (b) of Rule 8.7 states in part:

"Without limiting the foregoing [statement of a Market-Maker's continuous obligation to trade for his own account], a Market-Maker is expected to perform the following activities in the course of maintaining a fair and orderly market:

* * *

(ii) To make markets which, absent changed market conditions, will be honored to a reasonable number of contracts in all series of options classes at the station where a Market-Maker is present.

(iii) To update market quotations in response to changed market conditions in all series of options classes at the station where a Market-Maker is present."

The meaning of "a reasonable number of contracts" is explained in Interpretation and Policy .05 under Rule 8.7, as follows:

(over)

"Unless an options class is exempted by the Market Performance

Committee, under normal market conditions a Market-Maker's bid or offer for a series of options of unspecified size is for *five contracts* except that a Market-Maker may be compelled to buy or sell a specific number of contracts at the disseminated bid or offer pursuant to his obligations under Rule 8.51 [the "Firm Quote Rule", discussed below]."¹

Rule 8.7 makes it clear that a Market-Maker has the obligation to make and honor a market for at least five contracts not only in his appointed classes, but also in classes of options in which he does not hold an appointment whenever he enters a trading crowd in other than a floor brokerage capacity.

There is nothing in any rule or stated policy of the Exchange that limits or restricts this obligation of a Market-Maker to specific categories of persons, or that excludes categories of persons from those who are entitled to transact with a Market-Maker at his announced bid or offer. To the contrary, Rule 6.43 states that, "All bids and offers shall be general ones and shall not be specified for acceptance by particular members."

Accordingly, under the Rules of the Exchange, in normal market conditions a Market-Maker is obligated to make a two-sided market in all options traded at the station where the Market-Maker is present, and to trade in the size specified in his bid or offer, or for at least five contracts if no size is specified, with any other member, until the Market-Maker changes his quote. A Market-Maker must honor his quoted market to this extent even if the member who seeks to trade at the quoted bid or offer is another Market-Maker or a broker representing the order of a broker-dealer, which may be the order of a competing specialist or another Market-Maker on another exchange.

The obligation of each individual Market-Maker under Rule 8.7 as described above must be distinguished from the obligation of each trading crowd under Rule 8.51 (the "Firm Quote Rule"), which requires each crowd to be good for its displayed market for at least ten contracts in each series traded by the crowd. This obligation of the trading crowd is limited to non-broker-dealer customer orders. In respect of broker-dealer orders, in the event the crowd does not transact at its displayed quote, it becomes subject to the "trade or fade" requirement of paragraph (b) of Rule 8.51, and must change the displayed bid or offer to reflect that the previously displayed bid or offer is no longer available.

Notwithstanding that the ten contract obligation of a trading crowd under Rule 8.51 applies to public customer orders only, each Market-Maker, absent changed market conditions, must provide firm quotes for up to five contracts in all series traded at the post for all orders including broker-dealer orders.

Questions concerning this memorandum and any other questions concerning the obligations of competing market makers may be directed to Edward L. Provost, Operations Planning Division, at 312-786-7717.

1/ Rule 6.44, which generally requires that bids and offers made on the floor must be for one contract unless a different number is specified, is expressly subject to Rule 8.7, which imposes a five contract requirement on Market-Makers.