

Date: July 31, 1997

To: Member Firms and Associated Persons

From: Division of Regulatory Services

Re: Rules Governing Entry of Orders via RAES and Electronic Book

### **Prohibition on RAES Unbundling**

Please be advised that, pursuant to Exchange Rules 4.1 -- Just and Equitable Principles of Trade, 6.8(a)(1) -- RAES Operations in Equity Options, 7.4(a) -- Obligations for Orders and 24.15(a)(1) - RAES Operations in SPX/NSX, it is a violation of Exchange Rules for a member or an associated person to “unbundle” or split a customer order in an attempt to make the parts of the order eligible for execution via the Exchange’s RAES system.

Please note the following:

- The only orders eligible for execution via the RAES system are *small public customer market, or marketable limit, orders*. Eligible public customer orders are defined as orders for an account in which a member or non-member broker/dealer does not have an interest. In addition, currently (pursuant to a pilot program for which the Exchange expects to receive permanent approval), for orders that are otherwise RAES eligible, market and marketable limit orders tagged with AON (All or None), IOC (Immediate or Cancel), FOK (Fill or Kill), or MIN (Minimum quantity) will be executed on RAES. For MIN orders, the total order quantity must be within the RAES volume.
- Generally, orders eligible for RAES are orders for ten (10) contracts or fewer. Currently, this volume limit is subject to the following exceptions: OEX & SPX LEAPs, CK, OIL, & RN -- 20 contracts; SQP -- 25 contracts. Please note, these volume exceptions may change. A list of RAES eligible series and the applicable volume parameters is available from Exchange Systems Support at x7000.
- **Orders for more than the applicable contract limit are never eligible for execution via the RAES system and may not be split in an attempt to make the parts of the order eligible.**

### **Example of Prohibited Conduct—**

A member firm representative receives a public customer order for 100 contracts at its booth or at its upstairs office. This order is clearly ineligible for execution via RAES because it is for more than 10 contracts. It would be a violation of Exchange Rules to divide, split or unbundle the order into smaller orders (each for 10 contracts or fewer) and enter them for execution via RAES.

## **Regulatory Requirements Governing Entry of Orders Over Exchange Systems**

The increased access of such systems by non-member correspondent firms raises issues of internal control. The purpose of this circular is to remind member firms that there are regulatory requirements which must be adhered to when using such systems. For purposes of this circular, a correspondent of a member firm is any firm or customer that has been given access to the Exchange's systems by the member firm or by another correspondent of the member firm through the member firm's facilities.

- Members and member firms who accept, execute, clear and/or transmit agency orders for correspondent firms or who provide facilities for correspondent firms to enter orders for execution via any Exchange system including the Exchange's RAES system or the electronic public customer order book must provide written notice to all correspondent firms that explains the proper use of those systems, including the eligibility of orders for entry in the book or on RAES and the prohibition on unbundling RAES orders.
- When member firms provide facilities for correspondent firms to transmit orders for execution via Exchange systems, including the Exchange's RAES system or the electronic public customer order book, the member firms are required (1) to ensure that correspondents have adequate written procedures to monitor and supervise the entry of orders to minimize the misuse of Exchange systems and the potential for errors and (2) to require correspondent firms to receive written approval of the member firm before providing access to other correspondent firms/customers. *The word "adequate" in this circumstance means that member firms must assure themselves that their correspondents' written order entry procedures are reasonable under the particular circumstances of the correspondent.*
- Member firms may satisfy this requirement by (a) obtaining and maintaining as part of their books and records, a copy of their correspondents' written control procedures pertaining to electronic order entry or (b) establishing the procedures by which a correspondent must abide and having the correspondent sign an agreement stating that it will abide by such procedures.
- Any member firm failing to ensure that such steps have been taken with respect to a correspondent's use of Exchange systems may be subject to disciplinary action for the violative activity of the correspondent. Incidents of the prohibited conduct may result in disciplinary action being taken against the member or member firm, even when committed by persons associated with a correspondent firm.

### **Example of Prohibited Conduct—**

An order for 10 contracts in a RAES eligible series is routed to RAES through a member firm's facilities for the proprietary account of a non-CBOE member correspondent firm which is a registered broker/dealer. This order is clearly ineligible for execution via RAES because it is for the account of a broker/dealer.

Any questions regarding this memorandum may be directed to Pat Cerny at (312) 786-7722 in the Department of Market Regulation.