

TO: THE MEMBERSHIP

Regulatory Circular RG99-66

FROM: LEGAL DIVISION

DATE: MARCH 2, 1999

SUBJECT: AGENCY SUBSIDY RULE FILING

On February 26, 1999, the SEC approved the attached agency subsidy rule. The rule allows each market-maker crowd to volunteer to subsidize the activity of floor brokers who represent orders in that crowd and to lower each crowd's order book brokerage rate. Following a market-maker crowds' recommendation, the Equity Floor Procedure Committee (EFPC) will determine what the market-maker surcharge, if any, will be. The surcharge will be collected by the Exchange and will be used for two purposes. First, the amount collected will be used to reimburse the Exchange to the extent EFPC reduces the rate charged by the Exchange to execute Order Book Official (OBO) orders. Second, the remaining subsidy will be paid to the floor broker(s) as an inducement for that floor broker to reduce his or her brokerage rate. The Exchange believes this rule will enable market-maker crowds to compete more effectively for order flow by allowing the brokerage rates to be reduced.

The rule, including defined terms, is attached for your review; the following highlights key points.

- The subsidy applies to Stationary Floor Brokers (SFBs) in multiply traded classes in market-maker trading crowds.
- The subsidy is for Order Routing System (ORS) orders only.
- Any Resident Market-Maker may recommend a surcharge and/or an OBO rate reduction which may be voted on by that crowd's Resident Market-Makers.
- Each Resident Market-Maker's vote will be weighted equally.
- The surcharge that receives a majority of the votes cast will be recommended to EFPC.
- The Market-Maker Surcharge cannot exceed \$.25 per contract, and generally will be in effect for a minimum of one month.
- Although an SFB may be paid a surcharge, the SFB may charge any commission rate that SFB desires.
- Any SFB who receives any payments under this rule must disclose such payments to the SFB's customers.
- This rule will be in effect as a pilot program until March 31, 2000.

Questions regarding this pilot program should be addressed to Tom Bond, Vice Chairman, (312)786-7088; Phil Slocum, Member Trading Services, (312)786-5600; or Pat Cerny, Regulatory Services Division (312)786-7722.

**Chicago Board Options Exchange, Inc.**  
**Rules**

**CHAPTER II**

**ORGANIZATION AND ADMINISTRATION**

**PART C – Dues, Fees, and Other Charges**

**Market-Maker Surcharge for Brokerage**

**Rule 2.40**

*(a) Definitions.*

- (i) Stationary Floor Broker. A Stationary Floor Broker (“SFB”) in a particular option class is a floor broker (A) who has established a business in the trading crowd for that option class of accepting and executing orders for members or registered broker-dealers and (B) who transacted at least 80% of his orders for the previous month in the trading crowd at which that option class is traded.
- (ii) Resident Market-Maker. A Resident Market-Maker in a particular class of options is a market-maker who transacted at least 80% of his market-maker contracts in option classes traded in the trading crowd where the particular option class is traded in the prior calendar month.
- (iii) ORS Orders. For purposes of this Rule, an ORS order is an order that is (A) sent over the Exchange’s Order Routing System (“ORS”), (B) given an ORS identification number and (C) not an order of the firm for which the SFB acts as a nominee or for whom the SFB has registered his membership.
- (iv) Standard OBO Rate. The Standard OBO Rate is any rate for Order Book Official (“OBO”) floor brokerage established by the Exchange for the particular equity option class traded on the Exchange floor, other than pursuant to this Rule.
- (v) Standard Market-Maker Fees. Standard Market-Maker Fees are the total market-maker fees established by the Exchange for the particular option class other than any fees implemented pursuant to this Rule.
- (vi) Market-Maker Surcharge. The Market-Maker Surcharge is the amount of the fee, not to exceed 25¢ per contract, that the Exchange may impose on market-makers for a particular class of option pursuant to this Rule that is in addition to the Standard Market-Maker Fees for that class of option.

*(b) Generally.*

- (i) The appropriate Floor Procedure Committee may impose a Market-Maker Surcharge for transactions on a particular class of options, which Surcharge shall be imposed on a per contract basis for every contract traded by every market-maker, whether in-person or by order, in that option class during the period for which the Market-Maker Surcharge is in effect.
- (ii) In imposing the fee, the appropriate Floor Procedure Committee shall consider the vote of the Resident Market-Makers for a particular option class, as described in paragraph (d) of this Rule. In addition, the Committee shall consider the views of any market-maker in favor of or opposed to the recommended Surcharge or in favor of some other Surcharge amount. The Committee shall provide notice of its meeting schedule for the consideration of the Market-Maker Surcharge and the deadline for the submission of other materials for its consideration. The Committee shall determine the manner in

which it shall review the submitted materials and whether it shall allow personal appearances before the Committee. The Committee may delegate responsibility for reviewing submitted materials and to review other positions to a Sub-Committee provided the full Committee makes the final decision regarding whether the fee should be imposed and the amount, if any, of the Surcharge or any changes in the Surcharge. A decision of the appropriate Floor Procedure Committee may be appealed to the Exchange's Appeals Committee pursuant to Chapter XIX.; however, the Surcharge will be effective until the matter has completed the Exchange's review process. The appropriate Floor Procedure Committee through authority delegated by the Board of Directors will submit a rule filing pursuant to Section 19(b)(3) of the Exchange Act before the implementation of any new Surcharge or any change in the Surcharge or change in the OBO rate made pursuant to this Rule.

- (iii) The Market-Maker Surcharge will be used to reimburse the Exchange to the extent the appropriate Floor Procedure Committee reduces the OBO brokerage rate applicable to the particular class of options below the standard OBO Rate pursuant to paragraph (g) of this Rule. Any amount remaining after the Exchange has been reimbursed will be paid to every SFB in that option class who executed an ORS Order in that option class during the relevant period of time. To the extent more than one SFB executed ORS Orders during the relevant period, such remaining amount shall be paid to the SFBs on a pro rata basis based on the number of ORS contracts executed by the respective SFBs during the period. The Market-Maker Surcharge generally will be assessed after the end of the month in which transactions on which the Market-Maker Surcharge ~~fee~~ was based occurred.

(c) *Time Period.* The Market-Maker Surcharge generally shall be instituted for a minimum period of one month.

(d) *Vote to Recommend a Market-Maker Surcharge Amount .*

(i) Any Resident Market-Maker may recommend a Market-Maker Surcharge amount by the Friday prior to the vote or by any other time and date required by the appropriate Floor Procedure Committee. The vote of the Resident Market-Makers to recommend the Surcharge shall take place at the station where the applicable option class is traded on the Tuesday of expiration week for equity options, or on any other day selected by the Committee. The Committee shall provide 24 hour notice of the time and date of the vote to the trading crowd if the vote is to be held at a different time or on a different day. The Committee shall determine how the vote shall be conducted. Any Resident Market-Maker personally present at the trading station when the vote is conducted may vote on the amount of the Surcharge to be recommended. The Order Book Official at the particular trading post shall conduct the vote.

(ii) Each Resident Market-Maker's vote shall be weighted equally.

(iii) Any Surcharge amount that receives a majority of the votes cast shall be the Surcharge recommended to the appropriate Floor Procedure Committee. If any Surcharge amount does not receive a majority on the first ballot, the OBO may conduct subsequent ballots with the proposed Surcharges receiving the most votes or may solicit Resident Market-Makers for other proposed Surcharge-amounts.

(e) *Option Classes.* The appropriate Floor Procedure Committee may specify those option classes on which a Surcharge may be assessed pursuant to paragraph (b) of this Rule. In no event may the appropriate Floor Procedure Committee permit a Surcharge to be assessed on a class that is not also listed for trading on at least one other options exchange. In addition, the Surcharge may not be assessed for an option class that has been allocated to a Designated Primary Market-Maker.

*(f) Floor Brokerage Commission.* Although any SFB who executes ORS Orders may be paid a part of the Surcharge as provided in subparagraph (b)(iii) of this Rule, each SFB may charge any commission rate that SFB desires.

*(g) Book Brokerage Rates.* The appropriate Floor Procedure Committee may reduce the Exchange's OBO brokerage rate for a particular option class below the Standard OBO Rate upon a recommendation of the Resident Market-Makers pursuant to the terms of the vote in paragraph (d). In determining to reduce the OBO brokerage rate, the Committee shall consider not only the vote of the Resident Market-Makers, but also the views of any other floor broker or market-maker who submits views to the Committee pursuant to the published schedule for such submissions. Notice of the hearing, governance of the hearing, and all appeal rights shall be the same as those set forth in paragraph (b)(ii) of this Rule. If the Committee determines to reduce the OBO brokerage rate below the Standard OBO Rate, the Exchange will make the appropriate filing as required by the Exchange Act. To the extent the Committee reduces the OBO brokerage rate below the Standard OBO Rate, any Market-Maker Surcharge shall be used to reimburse the Exchange for the difference pursuant to paragraph (b)(iii). If the Exchange determines on its own initiative, otherwise than pursuant to this Rule, to lower the Standard OBO Rate for a particular equity option class, the Market-Maker Surcharge will not be used to reimburse the Exchange for such reduction.

*(h) Disclosure of payments.* Any SFB who receives any payment pursuant to paragraph (b)(iii) of this Rule must disclose the fact of such payment to its customers in a manner and frequency required by the Exchange or as otherwise may be required by Rule 10b-10 of the Securities Exchange Act of 1934.

*(i) Pilot program.* This Rule will be in effect as a pilot program until March 31, 2000.