



Date: March 1, 2005

To: Membership

Re: Remote Market Maker (“RMM”) Program

On February 4, 2005, the SEC published CBOE rule filing SR-CBOE-2004-75, which upon approval will allow for the implementation of the Remote Market Maker (“RMM”) program at the Exchange. The comment period for the rule filing closed on February 25, 2005. Assuming SEC approval shortly, the CBOE anticipates activation of the program during the second quarter 2005. The purpose of this circular is to provide details of the program as proposed in the published rules, as well as information on how interested parties may seek appointments as RMMs. Subsequent circulars will present a timetable for the launch of the program and provide additional operational details. To view a copy of the published RMM rules, go to the following website: <http://www.cboe.org/publish/LEGNotice/SR-CBOE-2004-75.pdf>

Overview

The RMM program will allow individuals and member organizations to stream quotes into designated Hybrid 2.0 classes from locations outside of the physical trading crowds. RMMs will be enabled to create customized class appointments, called virtual trading crowds (“VTCs”), which will allow them to cover a range of classes irrespective of their geographic locations on the CBOE trading floor. Only effective members and member firms (i.e. those approved for membership by the Exchange as RMMs who are either an owner or lessee of at least one membership) will be eligible to apply for VTC appointments.

Remote Market Maker Status

Upon approval of the published rules, designation as a Remote Market Maker will become an official membership status (such as market maker, floor broker, etc.). Members and member firms may apply for RMM status with the Exchange and this designation will appear on the membership records. There will be no limit on the aggregate number of RMMs exchange-wide, per class, or per crowd, with the exception that the total number of electronic quoters in any given class, including the DPM, eDPMs and on-floor and remote market makers, will be limited by bandwidth considerations defined explicitly in the rules. Additionally, since the program will use CBOE memberships as a baseline, participation may be limited due to membership availability.

RMM Class Appointments

Initially the RMM program will be applicable only to designated “Hybrid 2.0” classes. The Exchange intends to designate as Hybrid 2.0 the 602 most actively traded¹, multiply listed, hybrid enabled option classes, including any hybrid-enabled index or ETF option classes that fall within that range. The Exchange may designate additional classes as Hybrid 2.0 as conditions warrant.

RMMs will be able to request class appointments from among the available classes dependent on the number of memberships they intend to dedicate to their RMM appointment. Memberships used for an RMM appointment may not be used by any other member or for any other function.

¹ Based on national average daily volume for the most recent three months

The list of available Hybrid 2.0 classes will be divided into six tiers.

- Tier A+ will consist only of options on the QQQ and options on SPY.
- Tier A will consist of the next 20% most actively-traded classes (120 initially)
- Tier B will consist of the next 20%, with Tiers C through Tier E continuing as such, the 20% least actively-traded classes being in Tier E.

All memberships dedicated to an RMM appointment will be assigned an “appointment credit” of 1.0, regardless of whether an RMM owns or leases that membership, and all Hybrid 2.0 classes available for VTC appointments will be assigned an “appointment cost” as follows.

- Each Tier A+ product will have an appointment cost of .60 (or 3/5 of a seat)
- Each Tier A product will have an appointment cost of .10 (or 1/10 of a seat)
- Each Tier B class will have an appointment cost of .0667 (or 1/15 of a seat)
- Each Tier C class will have an appointment cost of .05 (or 1/20 of a seat)
- Each Tier D class will have an appointment cost of .04 (or 1/25 of a seat)
- Each Tier E class will have an appointment cost of .033 (or 1/30 of a seat)

Using this formula, RMMs will be enabled to construct a VTC using any combination of Hybrid 2.0 classes whose aggregate appointment cost does not exceed the total appointment credits of their dedicated memberships. For example, an RMM who owns or leases one seat could request five Tier A classes (5 x .1), two Tier B classes (2 x .0667), three Tier C classes (3 x .05) and six Tier E classes (6 x .033) to constitute the RMM’s appointment. The SPY and four tier A classes would cost one seat, as would the QQQ and 8 tier C classes, etc. If an RMM individual or organization wishes to own or lease multiple seats, the RMM’s potential appointment could expand accordingly.

The Exchange will rebalance the tiers once each calendar quarter beginning on September 30, 2005. This rebalancing may result in additions or deletions to the available class list or movement of classes among the tiers. When a class changes tiers it will be assigned a new appointment cost based on its new tier, and RMMs will be required to own or lease the appropriate number of dedicated memberships reflecting the revised appointment costs, or reduce their appointment cost by modifying their appointments. RMMs will be notified in advance of any changes to the list of option classes available for RMM appointment after a rebalancing in order to make appropriate changes to their either their appointments or to the number of seats they own or lease.

In the event the Exchange determines a class is no longer eligible for Hybrid 2.0 classification, those RMMs whose appointment previously included that class will be permitted one additional calendar quarter to continue quoting that class. At the end of that quarter, if the Exchange still deems that class ineligible for Hybrid 2.0, it will be removed from all RMM appointments. Alternatively, if the Exchange should designate a new class as Hybrid 2.0, RMMs may request that the subject class be added to their appointments, provided that adequate bandwidth is available and that the RMM has sufficient appointment credits for the new class tier.

Class Quoting Limit

The Exchange will limit the number of members quoting electronically in each class trading on the Hybrid 2.0 platform to ensure the stability of the system. The Class Quoting Limits (“CQL”) are determined by Tier and set forth in the rules. For the initial rollout period, the CQLs are as follows: 40 quoters for Tier A+ classes, 40 quoters for Tier A classes, 35 quoters for Tier B, 30 quoters for Tier C and 25 quoters for all other Hybrid 2.0 classes. Note that all members streaming quotes into a class count towards the CQL, whether they are on-floor or remote, and whether they are a DPM, eDPMs or market makers. Thus, if class XYZ in Tier A currently has 15 active quoters in the physical trading crowd, including the DPM and any e-DPMs, the maximum number of new quoters that can be appointed to that

class is 25, whether they are on-floor or RMMs. Please note that it is expected that these CQLs will increase over time.

Appointment Process

The Exchange will issue subsequent circulars that will define the appointment process. In general, it is expected that on a date in April 2005 to be announced soon, the CBOE will begin accepting requests for VTC appointments from effective RMM members and member organizations. On a specified time and date, RMMs will be directed to email a request for appointment to the Exchange that will enable them to participate in the class appointments. Those requests will be time-stamped upon receipt and used to place the applicant in the appointment request queue on a first come, first served basis. Once an order has been established, CBOE staff will contact each prospective RMM in order of their placement in the queue and process their class appointment requests. Only one request per RMM member or member firm will be accepted. Members will be allowed to request appointments in any available Hybrid 2.0 classes, and may indicate to the Exchange any contingencies they seek for the appointment. For example, a member may request appointments in all classes comprising an index or ETF, with specification that if all appointments cannot be granted the request should be canceled. Any requests for appointments that would cause a class to exceed its CQL will be wait-listed in the order in which they were received. After an RMM's class appointment request is processed, that RMM will receive a confirmation of those classes they have been appointed and those classes, if any, for which they have been placed in queue. More detail on this process will be distributed in the near future.

It is expected that the rollout of Hybrid 2.0 classes will take place over three months, and RMMs will not be required to possess the required number of memberships for their total appointment at the beginning of the rollout. However, they will be required to begin quoting their appointed classes as each is added to the RMM program, and therefore may need to own or lease an increasing number of memberships as the rollout proceeds.

The wait list for RMM appointments will operate on time priority. When a class can accommodate another electronic quoter (whether due to attrition or an increase in the CQL), the member at the top of the list will have priority. Once a member is wait-listed, the Exchange may not alter their position on the wait-list other than to improve it as a result of attrition or an increase in the CQL or to cancel it at the request of the member. **CLASS APPOINTMENTS, WHETHER OBTAINED THROUGH THE GRANDFATHER PROCESS DESCRIBED IN INFORMATION CIRCULAR IC05-25, OR THROUGH THE REMOTE MARKET MAKER APPOINTMENT PROCESS, MAY NOT BE SOLD, SWAPPED, TRANSFERRED OR SURRENDERED TO ANY OTHER MEMBER OR MEMBER FIRM. ALL APPOINTMENTS ARE SUBJECT TO THE TERMS PROVIDED IN CBOE RULES.**

Cancellation Fee

Due to the high demand expected for VTC appointments and the constraints of the CQLs, the Exchange plans to impose, subject to SEC approval and for the duration of the rollout, a cancellation/inactivity fee of \$1,000 per class if any RMM does not quote a confirmed appointment once it becomes active. This fee will apply whether a) an RMM decides to relinquish a confirmed appointment prior to end of the rollout period, or b) does not begin quoting an appointed class upon its activation in the program. In either case, the appointment will be revoked. This is to ensure that members and member firms only apply for those classes they fully intend to quote and do not keep vacant spaces in appointments that others may want. Following the completion of the rollout, RMMs will be eligible to relinquish their initial appointments and the cancellation fee will not apply.

RMM Obligations

The published rules obligate RMMs to provide continuous two-sided, minimum 10-up, legal-width quotations in 60% of the series in each of their appointed classes. Following activation of the program, the Equity Market Performance Committee (“EMPC”) will periodically conduct evaluations of all market makers to determine whether they have fulfilled performance standards relating to, among other things, market quality (size, width), competition among market makers, observance of ethical standards, administrative factors and quoting frequency. Any market maker who fails to adhere to minimum quoting and market quality requirements may be subject to revocation of a class appointment.

Membership and Seat Requirements

A Remote Market Maker must be an effective CBOE member or member firm at the time they request RMM class appointments. RMMs will not be required to possess all requisite memberships required for their requested and/or confirmed appointments until such time as the appointed classes have been rolled out on the RMM platform. The rollout schedule for RMM classes will be distributed at a later date. New individual and member firm RMMs will also be required to pass a CBOE membership exam, with the latter designating a Responsible Person to complete the test. Under CBOE Rule 3.9(g), any person applying to have an authorized trading function must have completed the Exchange’s Member Orientation Program and have passed an Exchange Trading Member Qualification Exam. There are two ways to complete this requirement.

- 1) Any person applying for membership may attend the regularly scheduled Member Orientation Program at The Options Institute at CBOE. This is a 4-day program that includes administering of the qualification exam. Prospective members attend classes from 9:00 a.m. to 4:00 p.m. for the first 3 days, with the qualification exam administered on day four. Individuals with experience in each of the topics teach all sessions.
- 2) Study materials will also be available online at www.cboe.com through CBOE’s online learning system in mid-March 2005. Prospective applicants and/or Responsible Persons may choose instead to study for the exam independently of the Orientation Program and take the exam at CBOE’s offices in New York City. Proctoring of the exam in any other locations will be subject to demand and availability of CBOE staff.

Please contact Stan Leimer, Director of the CBOE Membership Department, at (312) 786-7299 for information regarding applying for CBOE membership and/or obtaining a CBOE membership or go to the membership forms library at <http://www.cboe.org/>.

Fee Structure

At the recommendation of the Financial Planning Committee, and subject to the approval of both the Board of Directors and the SEC, RMMs will be charged a transaction fee of \$.26/contract.

Payment for Order Flow

RMMs will participate in the marketing fee program as a condition of their appointment in the same manner as do all trading floor market makers. All trades resulting from members quoting from off the floor will be subject to the \$0.22 marketing fee. Rebates of fees collected on market-maker to market-maker trades will be reflected on the member’s monthly statement.

Connectivity

Connections to CBOEdirect, whether from locations on or away from the trading floor, must be requested through a member's or member organization's clearing firm. CBOE will work with the clearing firms to process requests for connections. Please contact Curt Schumacher, Chief Technology Officer, at (312) 786-7564 if you have any questions about this subject.

Multiple RMMs within an Organization

The proposed rules governing RMMs would prohibit member firms from employing more than one RMM appointment in the same class(es) unless the units operating those RMMs meet certain qualifications that demonstrate their trading separation and independence. Organizations with multiple trading desks, divisions, independent contractors or sub-organizations may be permitted to request multiple RMM appointments in the same class(es) for each separate unit provided they meet the tests presented in the rule filing.

For those firms employing more than one CBOE membership for RMM appointments, the proposed rules would allow the firm to designate a single individual to oversee all RMM appointments across multiple memberships, subject to the terms provided in the rule filing.

For more detail on both topics, please see the rule filing.

Additional Information

The details provided here are based upon the published rule filings and may be subject to change, dependent on SEC actions. The membership will be advised in future circulars of the approval of the rules and specifications of the appointment process. In the interim, if you have any questions regarding the program, please contact Daniel Hustad, Vice President of Market Quality Assurance, at (312) 786-7715 or Angela Redell, Director of Market Quality Assurance, at (312) 786-7559. Any questions regarding the rule filing should be directed to Steve Youhn, Senior Managing Attorney, at (312) 786-7416.