

Regulatory Circular RG01-37

Date: March 15, 2001
To: Membership
From: MTS Appointments Committee
Re: Responsibilities and Obligations of Designated Primary Market Makers

In addition to the specific responsibilities of Designated Primary Market Makers ("DPMs") under Rules 8.80 through 8.91, each DPM has a general duty to administer and oversee the market in the DPM's allocated classes so as to foster full and fair competition among all orders represented in the crowd. This Regulatory Circular describes some of the more important responsibilities of DPMs in promoting competition in their trading crowds.

The DPM's Order Book Official Responsibilities

The DPM must perform all of the functions of the Order Book Official, pursuant to Rules 7.3 through 7.10. Only persons associated with the DPM organization who are members are allowed to execute orders and fulfill other member functions for the DPM. Non-member employees, including clerks and/or employees who wear "badges", are not allowed to execute orders or perform any other member functions for the DPM. (For more detailed information regarding requirements applicable to DPM clerks, members should refer to Regulatory Circular RG00-66.)

In CBOE's competitive auction market, the potential for the highest bids and lowest offers to interact assures that executions will take place at the best available prices. In all trading crowds, including DPM trading crowds, market makers and floor brokers acting on behalf of customers, market makers or other market professionals are important in providing liquidity to the market.

In DPM trading crowds, it is the special responsibility of the DPM to assure that any market maker who wishes to make a market in any class of option is permitted to do so, and that the bids and offers of such a market maker (or of a floor broker representing an order) are given the price and time priority to which they are entitled under Exchange Rules.

Included among the duties of a DPM is to assure that all bids and offers of market makers trading in-person at the DPM's station are promptly displayed if they improve the market. This requirement to display a market maker's better bid or offer applies even if the market maker's better bid or offer is for a smaller size than the size that the DPM may have committed to member firms concerning the size of the displayed quote in the DPM's assigned classes. (Rule 8.51.03 provides that market maker and other proprietary broker/dealer orders that in each case are for less than ten contracts and are represented in the crowd by the DPM or a floor broker should not be reflected in the displayed quote.)

The DPM's Floor Broker Responsibilities

Under Rule 6.43, the bids and offers of a DPM (whether bidding or offering on behalf of an agency order or for the DPM's own account) must be made by public outcry. When a DPM represents an order as agent, the DPM is obligated under Rule 6.73 to use due diligence in representing agency orders that the DPM holds as an agent, including those orders that may reside in the public limit order book. Under Rule 8.85(b)(i), the DPM is required to book all orders in the DPM's possession that are eligible to be booked unless (A) the DPM executes the order upon its receipt or (B) the customer who placed the order has requested that the order not be booked, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were a displayed order in the public order book. *The DPM's use of due diligence in executing an order includes making reasonable efforts to make as many members as possible aware of the DPM's request for a quotation.*

The DPM's Market Maker Responsibilities

A DPM may never purchase (sell) options for the DPM's own account while in possession of an unexecuted market or marketable limit order to purchase (sell) the same option unless the customer who has placed the order has consented to not being accorded such priority. A DPM may execute an agency order against the DPM's principal account only after giving the trading crowd an opportunity to match or better the DPM's quote.

Price and Time Priority

A DPM's right to participate as principal in a transaction is generally governed by the principles of price and time priority as set forth in Rule 6.45. Under these principles, if a DPM is first to respond with the best bid (offer) in response to a request for a market from a member not acting on behalf of the DPM, the DPM is entitled to participate up to 100% in any resulting transaction. Similarly, if a market maker is first to respond with the best bid (offer) in response to a request for a market and the market maker's bid (offer) is better than the DPM's previously established principal bid (offer), the market maker is entitled to participate up to 100% in any resulting transaction. A DPM's previously established principal bid (offer) means a bid (offer) previously announced by the DPM through open outcry or disseminated by the automatic quotation updating system in use in the DPM's allocated securities.

Where a DPM and one or more market-makers announce bids (offers) which establish the best bid (offer) *and the DPM was not previously bidding (offering) at that price*, the priority of bids and offers are as set forth in Rule 6.45. As such, the member who was first to respond at the best price (be it the DPM, a market-maker, or a floor broker) is entitled to participate up to the full amount of the order. In accordance with Rule 6.45, after the member with time priority has been satisfied, all other members bidding (offering) at the best price are entitled to participate based upon the sequence of their bids (offers).

DPM Participation Right

In addition to the above, to the extent established by the MTS Committee, a DPM has a participation right when the DPM's bid (offer) is not otherwise entitled to priority under Rule 6.45 if the DPM's previously established principal bid (offer) is equal to the highest bid (lowest offer) in the trading crowd. Specifically, a DPM has the right to participate for its own account with the market-makers present in the trading crowd in transactions in the DPM's allocated securities that occur at the DPM's previously established principal bid or offer. This participation right is applicable to all securities traded by DPMs including options as well as non-option securities traded pursuant to Chapter XXX of CBOE's Rules.

The DPM's participation right, as described above, in transactions that occur at its previously established principal bid or offer shall be as follows:

- **50%** when there is one market maker bidding (offering) at the DPM's previously established principal bid (offer) (i.e., is at parity with the DPM);
- **40%** when there are two market makers at parity with the DPM;
- **30%** when there are three or more market makers at parity with the DPM.

This participation right generally applies to all classes that are allocated to DPMs regardless of the volume in a particular class or whether or not the class is multiply listed. The MTS Committee also retains the authority to condition a DPM's appointment in accordance with the Rules by establishing a lower participation right in a class or classes allocated to the DPM.

Agency Orders

The DPM participation right is a right to participate with other market-makers and not with orders in the order book or orders represented in the trading crowd. Thus, to the extent that an agency order participates in a transaction on the same side of the market as the DPM, the DPM participation right applies solely to the remaining portion of the transaction on that side of the market after deducting the number of contracts executed against that agency order.

This regulatory circular supersedes Regulatory Circular RG00-75.

Questions concerning this memorandum and any other questions concerning the rights and obligations of DPMs may be directed to Daniel Hustad, Operations Planning Division, at 312-786-7715.