



Regulatory Circular RG06-49

Date: May 18, 2006
To: Members, Member Firms, and Order Providers
From: Equity and Index Options Procedure Committees
Re: Participation Entitlements Applicable to Crossing Orders in Open Outcry

A rule change that amends the open outcry crossing participation entitlement provisions of CBOE Rule 6.74, *Crossing Orders*, has become effective (see Release 34-53543; SR-CBOE-2006-21). A copy of the rule change, as well as revised CBOE Rule 6.74, is available on CBOE's website at www.cboe.org/Legal.

The rule change relates to the crossing participation entitlement components of Rule 6.74. Specifically, the filing sets forth applicable parameters that are determined on a class-by-class basis related to the entitlement. For each class that the appropriate procedure committee determines to apply a crossing participation entitlement, the committee also determines: (i) whether the crossing entitlement applies to facilitations (i.e., a cross of a public customer order with a facilitation order of the firm from which the customer order originated) and/or solicitations; (ii) the eligible size for an order that may be subject to the crossing entitlement, which may not be less than 50 contracts; and (iii) a crossing entitlement percentage of either 20% or 40% (after satisfying all public customer orders that were on the limit order book and represented in the trading crowd at the time the market was established).

In accordance with the revised rule, the Equity and Index Options Procedure Committees have determined the following:

- For the classes listed below, a Floor Broker is entitled to a crossing participation entitlement of **40%** (after satisfying public customer orders) for open outcry **facilitations and solicitations** of eligible orders of **50 contracts or more**:

ALL EQUITY OPTION CLASSES &

BBH	IGV	IWW	RKH	XLB
BDH	IWB	IWZ	RSP	XLE
DGT	IWC	IYE	RTH	XLF
DVY	IWD	IYH	SHY	XLI
EFA	IWF	IYY	SMH	XLK
HHH	IWN	LQD	SML	XLP
IAH	IWO	MDY	SWH	XLU
IBB	IWP	OIH	TLT	XLV
IDU	IWR	ONEQ	TTH	XLY
IEF	IWS	OOO	UTH	
IGN	IWV	PPH	WMH	

- For the classes listed below, a Floor Broker is entitled to a crossing participation entitlement of **40%** (after satisfying public customer orders) for open outcry **facilitations** (and not solicitations) of eligible orders of **50 contracts or more**:

DIA
IWM

OEF
RMN

SPY

- For the classes listed below, a Floor Broker is entitled to a crossing participation entitlement of **20%** (after satisfying public customer orders) for open outcry **facilitations** (and not solicitations) of eligible orders of **50 contracts or more**:

CYX
DJX
DTX
DUX
DXL
FVX
GOX
INX
IRX
MNX

MUT
MVR
NDX
OEX
OIX
PFU
POQ
POU
POY
PVC

PVF
PVK
PVL
PVO
PVP
PVU
QQQQ
RLG
RLV
RMC

RPY
RUT
SPX
TNX
TXX
TYX
VIX
XEO
XSP

Members seeking further information as to the open outcry crossing procedures applicable when there is a participation entitlement should refer to the rule change and paragraph (d) of CBOE Rule 6.74. Members seeking further information as to open outcry crossing procedures generally should refer to Rule 6.74 and Rule 6.9, *Solicited Transactions*, which are attached for reference. For any other questions, please contact Jennifer Lamie, Legal Division, at (312) 786-7576.

Rule 6.74. Crossing Orders

(a) A Floor Broker who holds orders to buy and sell the same option series may cross such orders, provided that he proceeds in the following manner:

(i) In accordance with his responsibilities for due diligence, a Floor Broker shall request bids and offers for such option series and make all persons in the trading crowd, including the Board Broker or Order Book Official, aware of his request.

(ii) After providing an opportunity for such bids and offers to be made, he must

(A) bid above the highest bid in the market and give a corresponding offer at the same price or at prices differing by the minimum increment or

(B) offer below the lowest offer in the market and give a corresponding bid at the same price or at prices differing by the minimum increment.

(iii) If such higher bid or lower offer is not taken, he may cross the orders at such higher bid or lower offer by announcing by public outcry that he is crossing and giving the quantity and price.

(b) A Floor Broker who holds an order for a public customer of a member organization and a facilitation order may cross such orders provided that he proceeds in the following manner.

(i) The member organization must disclose on its order ticket for the public customer order which is subject to facilitation, all of the terms of such order, including any contingency involving, and all related transactions in, either options or underlying or related securities.

(ii) In accordance with his responsibilities for due diligence, the Floor Broker shall disclose all securities which are components of the public customer order which is subject to facilitation and then shall request bids and offers for the execution of all components of the order.

(iii) After providing an opportunity for such bids and offers to be made, the Floor Broker must, on behalf of the public customer whose order is subject to facilitation, either bid above the highest bid in the market or offer below the lowest offer in the market, identify the order as being subject to facilitation, and disclose all terms and conditions of such order. After all other market participants are given an opportunity to accept the bid or offer made on behalf of the public customer whose order is subject to facilitation, the Floor Broker may cross all or any remaining part of such order and the facilitation order at such customer's bid or offer by announcing in public outcry that he is crossing and by stating the quantity and price(s). Once such bid or offer has been made, the public customer order which is subject to facilitation has precedence over any other bid or offer in the crowd to trade immediately with the facilitation order.

(c) During the opening rotation for a class of option contracts in the interests of achieving a single price opening, an exception may be made to the requirements of subparagraphs (ii) and (iii) of paragraph (a) above, and the Floor Brokers may proceed as follows:

(i) A Floor Broker may match all market orders in his possession in which no member or non-member broker/dealer has an interest;

(ii) The Floor Broker shall then announce by public outcry the number of contracts that he has matched and will cross at the opening price to be established; and

(iii) The Floor Broker may then continue to bid or offer the remaining unmatched and unexecuted orders he has in his possession for execution during the opening rotation.

(d) Notwithstanding the provisions of paragraphs (a) and (b) of this Rule, when a Floor Broker holds an option order for the eligible order size or greater ("original order"), the Floor Broker is entitled to cross a certain percentage of the order with other orders that he is holding or in the case of a public customer order with a facilitation order of the originating firm (i.e., the firm from which the original customer order originated). The appropriate Procedure Committee may determine on a class-by-class basis to include solicited orders within the provisions of paragraph (d) of this Rule. In addition, the appropriate Procedure Committee may determine on a class-by-class basis the eligible size for an order that may be transacted pursuant to paragraph (d) of this Rule, however, the eligible order size may not be less than 50 contracts. In accordance with his responsibilities for due diligence, a Floor Broker representing an order of the eligible order size or greater that he wishes to cross shall request bids and offers for such option

series and make all persons in the trading crowd, including the Order Book Official or the PAR Official, aware of his request.

(i) Once the trading crowd has provided a quote, it will remain in effect until: (A) a reasonable amount of time has passed, (B) there is a significant change in the price of the underlying security or index, as applicable, or (C) the market given in response to the request has been improved. (In the case of a dispute, the term "significant change" will be interpreted on a case-by-case basis by two Floor Officials based upon the extent of the recent trading in the option and in the underlying security, and any other relevant factors.)

(ii) The percentage of the order which a Floor Broker is entitled to cross, after all public customer orders that were (1) on the limit order book and then (2) represented in the trading crowd at the time the market was established have been satisfied, is either 20% or 40% (as determined by the appropriate Procedure Committee on a class-by-class basis) of the remaining contracts in the order if the order is traded at or between the best bid or offer given by the crowd in response to the Floor Broker's initial request for a market.

(iii) In determining whether an order satisfies the eligible order size requirement, any multi-part or complex order (including a spread, straddle, combination, or ratio order (or a stock-option order or security future-option order, as defined in Rule 1.1(ii)(b) and Rule 1.1(zz)(b), respectively) or any other complex order defined in Rule 6.53C) must contain one leg alone which is for the eligible order size or greater. If the same member organization is the originating firm and also the Designated Primary Market-Maker ("DPM") or Lead Market-Maker ("LMM") for the particular class of options to which the order relates, then the DPM or LMM is not entitled to any of the DPM or LMM guaranteed participation rate with respect to the particular cross transaction.

(iv) When facilitating a customer order pursuant to paragraph (d) of this Rule, a member organization must disclose on its order ticket for the public customer order which is subject to facilitation, all of the terms of such order, including any contingency involving, and all related transactions in, either options or underlying or related securities. The Floor Broker must disclose all securities that are components of the public customer order which is subject to facilitation before requesting bids and offers for the execution of all components of the order.

(v) If a trade pursuant to paragraph (d) of this Rule occurs at the DPM's or LMM's principal bid or offer in its appointed class, then the DPM's guaranteed participation level which is established pursuant to Exchange Rule 8.87 (or Exchange circulars issued pursuant to Exchange Rule 8.87) or LMM's guaranteed participation level which is established pursuant to Exchange Rule 8.15B shall apply only to the number of contracts remaining after all those public customer orders which trade ahead of the cross transaction and the number of contracts crossed, each as described in paragraph (d)(ii) of this Rule, have been satisfied. The DPM's or LMM's guaranteed participation will be a percentage that when combined with the percentage the originating firm crossed, does not exceed 40% of the order. If the trade occurs at a price other than the DPM's or LMM's principal bid or offer, the DPM or LMM is entitled to no guaranteed participation.

(vi) The members of the trading crowd who established the market will have priority over all other orders that were not represented in the trading crowd at the time that the market was established (but not over public customer orders on the book) and will maintain priority over such orders except orders that improve upon the market. A Floor Broker who is holding a customer order and either a facilitation or solicited order, and who makes a request for a market will be deemed to be representing both the customer order and either the facilitation order or solicited order, as applicable, so that the customer order and the other order will also have priority over all other orders that were not being represented in the trading crowd at the time the market was established.

(vii) Nothing in this paragraph is intended to prohibit a Floor Broker, a DPM, or a LMM from trading more than his percentage entitlement if the other members of the trading crowd do not choose to trade the remaining portion of the order.

(viii) The appropriate Procedure Committee may exempt a particular option class from the application of paragraph (d) of this Rule.

(e) Reserved

(f) Open Outcry "SizeQuote" Mechanism

(i) SizeQuotes Generally: The SizeQuote Mechanism is a process by which a floor broker ("FB") may execute and facilitate large-sized orders in open outcry. Floor brokers must be willing to facilitate the entire size of the order for which they request SizeQuotes (the "SizeQuote Order") or to execute it against one or more solicited orders, or against a combination of solicited and facilitation orders. The appropriate Market Performance Committee shall determine the classes in which the SizeQuote Mechanism shall apply. The SizeQuote Mechanism will operate as a pilot program which expires February 15, 2007.

(A) Eligible Order Size: The appropriate MPC shall establish the eligible order size however such size shall not be less than 250 contracts.

(B) In-crowd Market Participants: The term "in-crowd market participants" ("ICMPs") shall be as defined in CBOE Rule 6.45A.

(C) Public Customer Priority: Public customer orders in the electronic book have priority to trade with a SizeQuote Order over any ICMP providing a SizeQuote response at the same price as the order in the electronic book.

(D) DPM and LMM Participation Rights: The DPM and LMM participation entitlement shall not apply to SizeQuote transactions.

(E) FBs may not execute a SizeQuote Order at a price inferior to the national best bid or offer ("NBBO"). Unless a SizeQuote request is properly canceled in accordance with paragraph (iv), a FB is obligated to execute the entire SizeQuote Order at a price that is not inferior to the NBBO in situations where there are no SizeQuote responses received or where such responses are inferior to the NBBO.

(ii) SizeQuote Procedure: Upon request by a FB for a SizeQuote, ICMPs may respond with indications of the price and size at which they would be willing to trade with a SizeQuote Order. After the conclusion of time during which interested ICMPs have been given the opportunity to provide their indications, the FB must execute the SizeQuote Order with ICMPs and/or with a firm facilitation order and/or solicited order(s) in accordance with the following procedures:

(A) Executing the Order at ICMP's Best Price: ICMPs that provided SizeQuote responses at the highest bid or lowest offer ("best price") have priority to trade with the SizeQuote Order at that best price. Allocation of the order among ICMPs shall be prorata, up to the size of each ICMP's SizeQuote response. The FB must trade at the best price any contracts remaining in the original SizeQuote Order that were not executed by ICMPs providing SizeQuote responses.

(B) Executing the Order at a Price that Improves upon ICMP's Price by One Minimum Increment: ICMPs that provided SizeQuote responses at the best price ("eligible ICMPs") have priority to trade with the SizeQuote Order at a price equal to one trading increment better than the best price ("improved best price"). Allocation of the order among eligible ICMPs at the improved best price shall be prorata, up to the size of each eligible ICMP's SizeQuote response. The FB must trade at the improved best price any contracts remaining in the original SizeQuote Order that were not executed by eligible ICMPs.

(C) Trading at a Price that Improves upon ICMP's Price by More than One Minimum Increment: A FB may execute the entire SizeQuote Order at a price two trading increments better than the best price communicated by the ICMPs in their responses to the SizeQuote request.

(iii) Definition of Trading Increments: Permissible trading increments are \$0.05 for options quoted below \$3.00 and \$0.10 for all others. In classes in which bid-ask relief is granted pursuant to CBOE Rule 8.7(b)(iv), the permissible trading increments shall also increase by the corresponding amount. For example, if a series trading above \$3.00 has double-width bid-ask relief, the permissible trading increment for purposes of this rule shall be \$0.20.

(iv) It will be a violation of a FB's duty of best execution to its customer if it were to cancel a SizeQuote Order to avoid execution of the order at a better price. The availability of the SizeQuote Mechanism does not alter a FB's best execution duty to get the best price for its customer. A SizeQuote request can be canceled prior to the receipt by the FB of responses to the SizeQuote request. Once the FB receives a response to the SizeQuote request, if he/she were to cancel the order and then subsequently attempt to execute the order at an inferior price to the previous SizeQuote response, there would be a presumption that the FB did so to avoid execution of its customer order in whole or in part by others at the better price.

... Interpretations and Policies:

.01 The term "public customer of a member organization" shall mean, in connection with Rules 6.53(m) and 6.74(b), a customer that is neither a member nor a broker/dealer.

.02 When accepting a bid or offer made on behalf of a public customer, all contingencies of the public customer order must be satisfied.

.03 Spread, straddle, stock-option (as defined in Rule 1.1(ii)), inter-regulatory spread as defined in Rule 1.1(II) (including security future-option orders as defined in Rule 1.1(zz) or combination orders on opposite sides of the

market may be crossed, provided that the Floor Broker holding such orders proceeds in the manner described in paragraphs (a) or (b) above as appropriate. Members may not prevent a spread, straddle, stock-option, inter-regulatory spread (including a security future-option order) or combination cross from being completed by giving a competing bid or offer for one component of such order.

.04 Where a related order must be effected in another market, the member must take steps to transmit the related order(s) concurrently with the execution of the options leg(s) of the order. A trade representing the execution of the options leg of a stock-option order or a security future-option order may be cancelled at the request of any member that is a party to that trade only if market conditions in any of the non-Exchange market(s) prevent the execution of the non-option leg(s) at the price(s) agreed upon.

.05 Where a Floor Broker has been continuously representing a limit order to buy or sell equity option contracts in a trading crowd at a limit price which is equal to the highest bid or lowest offer ("resting order"), and subsequently receives a market or marketable limit order to sell or buy that same option series, the Floor Broker may cross the resting order with the subsequent market order or marketable limit order in accordance with the requirements of paragraph (a) of Rule 6.74, but without regard to the provision of subparagraph (a)(iii) that permits a cross only if such higher bid or lower offer is not taken, in order to permit both the resting order and a subsequent market or marketable limit order to compete equally with other bids and offers in the trading crowd. The Rules pertaining to solicited orders, facilitation crosses and the priority provisions of Rule 6.45 shall continue to apply.

.06 The phrase "terms and conditions," as used in this rule with respect to an order that is subject to facilitation, refers to class; series; volume; option price; any contingencies; and any components related to the order (e.g., stock, options, futures or other related instruments or interests). However, the class will be deemed to be disclosed to the trading crowd if it is apparent that the crowd is aware of which class is being traded, (e.g., if the pit in which the transaction occurs is designated for one option class only, or if the class is the only one in the trading post trading at the disclosed strike price, then it would be apparent which option class is being traded).

.07 A Floor Broker, pursuant to paragraph (d) of this Rule, may not cross an order that he is holding with an order from a market-maker that is then in the trading crowd.

.08 Paragraph (d) of this Rule supersedes the priority provision of paragraph (d) of Rule 6.9, *Solicited Transactions*, in those situations where the Floor Broker representing an order eligible for this paragraph determines to take advantage of the crossing provisions of Rule 6.74(d) in an option class that allows solicited orders to be crossed. Specifically, while Rule 6.9(d) provides that non-solicited market-makers and floor brokers holding non-solicited discretionary orders in the trading crowd will have priority over the solicited person or the solicited order to trade with the original order at the best bid or offered price, Rule 6.74(d) provides the solicited person or order with priority over all other parties (other than certain public customer orders) for either 20% or 40% of the contracts remaining in the order, as determined by the appropriate Exchange procedures committee, after those certain public customer orders have been satisfied.

Rule 6.9. Solicited Transactions

A member or member organization representing an order respecting an option traded on the Exchange (an "original order"), including a spread, combination, or straddle order as defined in Rule 6.53, a stock-option order as defined in Rule 1.1(ii) or a security future-option order as defined in Rule 1.1(zz), may solicit a member or member organization or a non-member customer or broker-dealer (the "solicited person") to transact in-person or by order (a "solicited order") with the original order. In addition, whenever a floor broker who is aware of, but does not represent, an original order solicits one or more persons or orders in response to an original order, the persons solicited and any resulting orders are solicited persons or solicited orders subject to this Rule. Original orders and solicited orders are subject to the following conditions.

(a) *Disclosed original order and matching solicited order that improves the market.* If the terms and conditions of the original order are disclosed to the trading crowd prior to the solicitation and the original order is continuously represented in the crowd throughout the solicitation process without any change in the terms and conditions of the order, and if the solicited person or the solicited order matches the original order's limit and improves the best bid or offer in the trading crowd, then the solicited person or the solicited order will have priority over non-solicited market makers and floor brokers representing non-solicited discretionary orders in the trading crowd and may trade with the original order at the improved bid or offered price subject to customer limit order book priorities set forth in Rule 6.45.

(b) *Disclosed original order that is later modified to meet a solicited order improving the market.* If the terms and conditions of the original order are disclosed to the trading crowd prior to the solicitation and the original order is continuously represented in the crowd throughout the solicitation process, and if the solicited person or the solicited order improves the best bid or offer in the crowd but does not match the original order's limit, and if thereafter the original order is modified to match the solicited order's bid or offer, then the following principles apply:

(i) prior to executing the modified original order with the solicited person or solicited order or crossing the modified original order with the solicited order, the member initiating the original order must announce to the trading crowd all the terms and conditions of the original order as modified, and

(ii) bids or offers thereafter made in the crowd will have priority pursuant to CBOE Rule 6.45 and may trade with the original order as modified, in the sequence in which they are made.

(c) *Disclosed original order that is later modified to meet a solicited order not improving the market.* If all the terms and conditions of the original order are disclosed to the trading crowd prior to the solicitation and the original order is continuously represented in the crowd throughout the solicitation process, and if the solicited person or the solicited order's bid or offer matches but does not improve the best bid or offer in the trading crowd and does not meet the original order's limit, and if thereafter the original order is modified to match the best bid or offer, then non-solicited market-makers and floor brokers with non-solicited discretionary orders in the trading crowd will have priority over the solicited person or the solicited order and may trade with the modified original order at the best bid or offered price subject to customer limit order book priorities set forth in Rule 6.45.

(d) *Undisclosed original order.* If the terms and conditions of the original order are not disclosed to the trading crowd prior to the solicitation, then, prior to crossing the original order with the solicited order or executing the original order with the solicited person or his agent, the member initiating the original order or his agent must disclose all the terms and conditions of the original order to the trading crowd. Non-solicited market-makers and floor brokers holding non-solicited discretionary orders in the trading crowd will have priority over the solicited person or the solicited order to trade with the original order at the best bid or offered price subject to customer limit order book priorities set forth in Rule 6.45.

(e) *Trading based on knowledge of imminent undisclosed solicited transaction.* It will be considered conduct inconsistent with just and equitable principles of trade and a violation of Rule 4.1 for any member or person associated with a member, who has knowledge of all material terms and conditions of an original order and a solicited order, including a facilitation order, that matches the original order's limit, the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option of the same class as an option that is the subject of the original order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument until either (i) all the terms and conditions of the original order and any changes in the terms and conditions of the original order of which that member or associated person has knowledge are disclosed to the trading crowd or (ii) the solicited trade can no longer reasonably be considered imminent in view of the passage

of time since the solicitation. For purposes of this paragraph (e), an order to buy or sell a "related instrument," means, in reference to an index option, an order to buy or sell securities comprising ten percent or more of the component securities in the index or an order to buy or sell a futures contract on any economically equivalent index. With respect to an SPX option, an OEX option is a related instrument, and vice versa.

(f) *All orders initiated as a result of a solicitation must be marked "SL."* If the solicited person is on the trading floor and elects to participate by order, the solicited person must retain a copy of the solicited order on the trading floor so long as the order is active.

. . . Interpretations and Policies:

.01 This Rule applies to all solicited orders, including, but not limited to, facilitation orders and orders resulting from solicitations of customers, non-member broker-dealers, members and member firms, and market-makers.

.02 A member initiating an original order is not required to announce to the trading crowd that another person has been solicited to participate in the order. The initiating member, however, must disclose to the trading crowd all the terms and conditions of the original order, and any modifications, as prescribed in this Rule.

.03 In respect of any solicited order that is a spread, straddle or combination order as defined in Rule 6.53, the terms "bid" and "offer" as used in subparagraphs (a)-(d) of this Rule 6.9 mean "total net debit" and "total net credit," respectively.

.04 Except as provided in Rule 6.9(a), the procedures set forth in Rule 6.74 ("Crossing Orders") govern the crossing of original orders with facilitation orders or solicited orders as determined by the appropriate Procedure Committee pursuant to Rule 6.74(d).

.05 The provisions of Rule 6.45 ("Priority of Bids and Offers") govern the priority of bids and offers, including the priority of a bid or an offer in relation to an original order on the same side of the market. For example, an original order to buy an option contract will take priority over other bids at the same price only as provided in Rule 6.45.

.06 Disclosing all the terms of the original order and any changes in the terms and conditions of the original order to the crowd prior to effecting a trade does not provide a safe harbor from possible violations of front-running prohibitions. Front-running is considered to be a violation of Exchange Rule 4.1, *Just and Equitable Principles of Trade*, as described in Exchange Regulatory Circular RG94-76.

.07 The phrase "terms and conditions," as used in this rule with respect to an order that is subject to facilitation, refers to class; series; volume; option price; any contingencies; and any components related to the order (e.g., stock, options, futures or other related instruments or interests). However, the class will be deemed to be disclosed to the trading crowd if it is apparent that the crowd is aware of which class is being traded, (e.g., if the pit in which the transaction occurs is designated for one option class only, or if the class is the only one in the trading post trading at the disclosed strike price, then it would be apparent which option class is being traded).