## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–45829; File No. SR–CBOE–00–55]**

## Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the Chicago Board Options Exchange, Incorporated To Establish Rules for a Screen-Based Trading System Known as CBOE*direct*

April 25, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on November 9, 2000, the Chicago Board Options Exchange, Incorporated (''CBOE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. CBOE submitted Amendment Nos. 1, 2, and 3 to the proposal on October 29, 2001; April 2, 2002; and April 19, 2002, respectively.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to adopt rules governing its screen-based trading system, known as CBOE*direct*, which will initially be used to trade options only when the open outcry option market is not open. The text of the proposed rule change, as amended, is set forth below. All of the text below would be new CBOE rules; this proposal would not amend or delete any existing CBOE rule.

* * * * *

### Chapter XL

*Introduction*

The rules in Chapters XL (40) through XLIX (49) are applicable only to trading on the Exchange's screen based trading system. Trading of securities on the screen based trading system shall also be subject to the rules in Chapters I through XXVII to the same extent such rules apply to the trading of the products to which those rules apply, in some cases supplemented by the rules in Chapters 40 through 49, except for rules that have been replaced by rule in Chapters 40 through 49 and except where the context otherwise requires. Whenever a rule in Chapters 40 through 49 supplements or, for purposes of trading on the screen based trading system replaces such rules in Chapters I through XXVII, that fact is indicated following the rule in these Chapters 40 through 49. Appendix A to the screen based trading rules lists the rules in Chapters I (1) through XXVII (27) that are applicable to the trading on the screen based trading system. Where appropriate, Appendix A also indicates that a rule in Chapter 1 through 27 has been supplemented by a rule in these screen based trading rules. All references in the rules in Chapters 1 through 27 to the Exchange shall mean SBT System also unless the context dictates otherwise.

* * * * *

*Definitions*

Rule 40.1

(a) For purposes of the rules governing the use of the Exchange's Screen Based Trading System, any term defined in Article I of the Constitution or in Rule 1.1 and not otherwise defined in Chapters 40 through 49 shall have the meaning assigned to such term in either Article I or in Rule 1.1.

SBT System

(b) ''Screen Based Trading System'' or ''SBT System'' means the electronic system administered by the Exchange which performs the functions set out in Exchange rules including controlling, monitoring, and recording trading by members through SBT workstations and trading between members.

Application Program Interface

(c) ''Application Program Interface'' or ''API'' means the computer program that allows Traders on their own computers or on CBOE or third-party vendor-supplied workstations to interface with the SBT System.

SBT Book

(d) ''SBT Book'' means all unexecuted orders, other than spread orders, currently held by the SBT System.

SBT Spread Book

(e) ''SBT Spread Book'' means all unexecuted spread orders, currently held by the SBT System.

SBT Workstation

(f) ''SBT workstation'' means a computer connected to the SBT System for the purposes of trading pursuant to the rules in these Chapters 40 through 49.

Trading Official

(g) ''Trading Official'' means an Exchange employee or member who is granted certain duties under these Rules to take actions affecting either the operation of the SBT System or to take actions affecting the responsibilities of SBT Traders.

SBT Trader

(h) ''SBT Trader'' means an individual member who or member organization which has the right to trade on the SBT System.

Market Turner

(i) ''Market Turner'' means an SBT Trader who was the first to enter an order (quote) at a better price than the previous best book price and the order (quote) is continuously in the market until the particular order trades. There may be a Market Turner for each price at which a particular order trades.

Legal Width Market

(j) ''Legal Width Market'' means a bid and offer for a prescribed size or greater that is at or within the prescribed width as set forth in Rule 44.4. While a legal width market is equivalent to the ''maximum quote width'' in width, Rule 44.4 requires that an SBT market-maker enter both the bid and offer to receive credit for the quote. A legal width market can be established by a bid and offer that are entered by two different SBT Traders.

Extended Trading Hour Session

(k) ''Extended Trading Hour Session'' or ''ETH Session'' is any period of time during which the SBT System is open for trading other than the regular trading hour session for those products traded during the ETH session.

* * * * *

*Application of Other Rules*

Rule 40.2

(a) To the extent the rules in Chapters I through XXXI are applicable to trading on the SBT System (as indicated by the context or by Appendix A to these Chapters XL through XLIX), the terms used in Chapters I through XXXI should

---

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letters from Angelo Evangelou, Legal Division, CBOE, to Nancy Sanow, Division of Market Regulation (''Division''), Commission, dated October 25, 2001 (''Amendment No. 1''); April 1, 2002 (''Amendment No. 2''); and April 18, 2002 (''Amendment No. 3''). In Amendment No. 1, CBOE substantially revised the proposed rule change; the proposed rule text and description of the proposal submitted as part of Amendment No. 1 supercedes those provisions of the original submission. In Amendment No. 2, CBOE substantially revised its proposed trade nullification rule for CBOE*direct*. In Amendment No. 3, CBOE further modified the proposed trade nullification rule.

be read to have the following meanings where appropriate:

(1) ''Floor'' should be read to mean SBT System.

(2) ''Floor Official'' should be read to mean Trading Official.

(3) ''Appropriate Floor Procedure Committee'' should be read to mean ''appropriate SBT Trading Committee.''

(4) ''Floor Broker'' should be read to mean ''SBT Broker.''

(5) ''Market-Maker'' should be read to mean ''SBT Market-Maker.''

(6) ''DPM'' should be read to mean ''SBT DPM.''

(b) References in rules to ''the Exchange'' should be read to include the SBT System where appropriate.

* * * * *

**Chapter XLI**

*Market Participants, Market Access and Securities Dealt In*

* * * * *

Market Participants

Rule 41.1

(a) The SBT Traders in the SBT System shall be:

(1) SBT Market-Makers—members who are either SBT Standard Market-Makers, SBT Lead Market-Makers or SBT Designated Primary Market-Makers;

(2) SBT Standard Market-Makers—members who have agreed to fulfill certain market making obligations thus qualifying for defined benefits;

(3) SBT Lead Market-Makers—SBT Standard Market Makers who have a higher level of market-maker obligations and a greater level of benefits for those classes in which they act as SBT Lead Market-Makers. SBT Lead Market-Makers generally act in such capacity on a rotating basis;

(4) SBT Designated Primary Market-Makers—members who are qualified and obligated to fulfill a higher level of market-maker obligations than SBT Standard Market-Makers thus qualifying for a greater level of defined benefits;

(5) SBT Brokers—members who enter orders as agents for accounts other than accounts of SBT Market-Makers;

(6) Proprietary Traders—members who enter orders as principal for non-market-maker proprietary accounts;

(b) Other users of the SBT System are:

(1) Clearing Firm Users—members who monitor and regulate the activities of traders trading through the clearing firm;

(2) SBT System Operators/Administrators—Exchange employees who support the operation of the system.

* * * * *

Registration of Membership

Rule 41.2

Any Exchange member who chooses to participate on the SBT System must apply with the Membership Committee to act as an SBT Market-Maker, SBT Broker, or Proprietary Trader. The Membership Committee shall be responsible for approving applications of Exchange members as an SBT Market-Maker, SBT Broker, or Proprietary Trader for the SBT System.

* * * * *

Communication Access

Rule 41.3

The connection point for any SBT workstation must be in the United States except as otherwise provided for by the Board. The Exchange may limit the locations of any SBT workstations to specified locations or cities if necessary to ensure the operational integrity of the System.

* * * * *

Replacement Traders

Rule 41.4

(a) If the SBT System is so enabled to recognize Replacement Traders, Individual SBT Market-Makers may nominate a Replacement Trader that must be qualified and registered with the Exchange as such. The Membership Committee shall be responsible for qualifying and approving Replacement Traders. Replacement Traders for a nominee of a member firm must be nominees of the same firm or must have their memberships registered for the same firm.

(b) When an SBT Market-Maker logs off the SBT System, he may first choose to transfer his position to a Replacement Trader. Any quotes transferred in that manner will retain their priority.

* * * * *

**Chapter XLII**

*Trading Day and States of Operation*

* * * * *

Days and Hours of Business

Rule 42.1

The days and hours of business shall be determined in accordance with the applicable rules for the type of product; *e.g.,* equity options—Rule 6.1, index options—Rule 24.6, etc. The Board of Directors may determine to approve hours of trading and days of operation for categories of products traded on the SBT System that are different than those approved for trading on the Exchange's open outcry system on the Exchange floor.

* * * * *

States of Operation

Rule 42.2

(a) Pre-Opening. Pre-opening is some pre-determined period of time (as described in Rule 42.3), as determined by the Exchange, prior to the opening during which the SBT System will accept orders and quotes, but during which no trading will take place.

(b) Opening. During the Opening State, the System will accept orders and quotes for some period of time (as described in Rule 42.3) as determined by the Exchange. At the end of that period of time, quotes and orders will be accepted for some period of time (but will not be included in the opening trade). During this time, the length of which is determined by the Exchange, opening prices are established. At the end of the Opening State, the System will complete the opening trades, if any, and then change the state of the class to Trading.

(c) Trading. During Trading, the series will trade freely and orders and quotes will be accepted.

(d) Trading Halts. During Trading Halts as declared in accordance with Rule 43.4(b), orders are accepted by the System. The class will have to go through the pre-opening and opening procedures before it reverts to the state of Trading.

(e) Closed. The System changes the state to Closed at a predetermined time dependent on the closing time of the underlying security. Trading is stopped but the System continues to accept certain types of orders to allow SBT Traders to maintain their orders. At some designated time the System stops accepting orders and performs end-of-day procedures as described in Rule 42.4.

* * * * *

Opening and Closing Rotation Procedures

Rule 42.3

(a) For some period of time before the opening (as determined by the Exchange) in the underlying security, the SBT System will accept orders and quotes. Spread orders and contingency orders (except ''opening only'' orders) do not participate in the opening. The SBT System will disseminate information about resting orders in the SBT Book that remain from the prior business day and any orders sent in before the opening. After the primary market for the underlying security disseminates the opening trade or the

opening quote for the underlying security, the SBT System sends a notice to SBT Market-Makers with an appointment in that class of options who may then submit their opening quotes. If there is an SBT Designated Primary Market-Maker (''SBT DPM'') or an SBT Lead Market-Maker (''SBT LMM'') in the particular option class, the SBT DPM or SBT LMM must enter opening quotes. Standard SBT Market-Makers may but are not required to enter an opening quote unless required by the procedure described in paragraph (b) below. The SBT System will begin the Opening Procedure at a randomly selected time within a number of seconds after the receipt of the underlying security's opening price. In the case of trading during an ETH session, the System may open the class without having received the underlying security's opening price. Spread orders and contingency orders do not participate in the opening trade or in the determination of the opening price.

(b)(1) For series that have no SBT Market-Makers with appointments logged on to the System and no SBT Market-Makers without appointments providing pre-opening quotes, the System will issue an alert message to the Help Desk at a prescribed time before the open. The Help Desk may contact SBT Market-Makers with an appointment to request that the Market-Makers log on and prepare to quote any series in the class. If a sufficient number of SBT Market-Makers can not be encouraged to log on, then the Help Desk may have the Opening Notice sent to some or all other SBT Market-Makers logged on to the System. A Special Request for Quote, which may be sent to the SBT Market-Makers with an appointment, is an RFQ that will require a response.

(2) For series where SBT Market-Makers have logged on but have not responded to the Opening Notice, and where no non-appointed SBT Market-Makers have provided pre-opening quotes, the System will send an alert message to the Help Desk and a Special RFQ to those SBT Market-Makers with an appointment.

(c) From some time after the Opening Notice is sent, the SBT System will calculate and provide the Expected Opening Price (''EOP'') given the current resting orders during an EOP Period. The EOP Period shall be a time established by the appropriate SBT Trading Committee and shall be no less than five seconds and no more than one minute. The EOP is that price at which the greatest number of orders in the SBT Book would be traded. The EOP will be re-calculated and disseminated every few seconds. During this time after the Opening Notice is sent, quotes and orders may be submitted without restriction. An EOP can only be calculated if an opening trade is possible. An opening trade is possible if: (i) the SBT Book is crossed (highest bid is higher than the lowest offer), locked (highest bid equals lowest offer), or there are market orders in the SBT Book, and (ii) at least one quote is present that is at or within the legal width market and of the prescribed minimum size as set forth in Rule 44.4.

(d) After the EOP Period, the System will enter a Lock Interval during which quotes and orders may be submitted but they are not included in the opening trade. The Lock Interval shall be a period of time not to exceed four seconds. The SBT System will establish the opening price at this time during its Opening Procedure. The System will process the series of a class in a random order. The opening price of a series is the ''market-clearing'' price which will leave bids and offers which cannot trade with each other. In determining the priority of orders to be filled, the SBT System will give priority to market orders first, then to limit orders whose price is better than the opening price and entered before the Lock Interval, and then to resting orders at the opening price and entered before the Lock Interval. One or more series of a class may not open because of conditions cited in paragraph (f) of this Rule. Orders entered during the Lock Interval will be eligible to be traded (according to the time priority in which they were entered) after the System enters the Trading State.

(e) As the opening price is determined by series, the System will change the product state of the series to Trading, and disseminate to OPRA and to the SBT participants the opening quote and the opening trade price, if any. Quotes and orders entered during the Lock Interval will then be submitted to the SBT Book in the order of their arrival.

(f) The System will not open a series if one of the following conditions is met:

(1) There is no quote from any SBT Market-Maker that provides a legal width market;

(2) The opening price is not within an acceptable range (as determined by the appropriate SBT Trading Committee) compared to the highest quote offer and the lowest quote bid (*e.g.,* the upper boundary of the acceptable range may be 125% of the highest quote offer and the lower boundary may be 75% of the lowest quote bid); or

(3) The opening trade would leave a market order imbalance (*i.e.,* there are more market orders to buy or to sell for the particular series than can be satisfied by the limit orders and the market orders on the opposite side).

(g) If one of the conditions in paragraph (f) of this Rule is met, the System will not open the series but will send a Request for Quote (''RFQ'') with no size, except when the condition in (f)(3) is met. In this case, the RFQ will include a size equal to the market order imbalance and the direction (buy or sell) of the imbalance. At the end of the RFQ period, the System will put the series into Opening Rotation. The System will repeat this process until the series is open.

(h) Two Trading Officials may deviate from the standard manner of the opening procedure, including delaying the opening in any option class, when they believe it is necessary in the interests of a fair and orderly market.

(i) The procedure described in this Rule may be used to reopen a class after a trading halt.

(j) Closing Rotation Procedure. The procedure described in this Rule may be employed after the end of the normal close of any trading session whenever the Exchange concludes that such action is appropriate in the interests of a fair and orderly market. The factors that may be considered in holding a closing rotation procedure include, but are not limited to, whether there has been a recent opening or reopening of trading in the underlying security, a declaration of a fast market, or a need for a closing procedure in connection with expiring individual stock options, an end of the year procedure, or the restart of a procedure which is already in progress. The decision to employ a closing rotation procedure in non-expiring options shall be disseminated prior to the commencement of such procedure.

* * * * *

End of Day/Session Process

Rule 42.4

The System will automatically delete expiring orders (*i.e.,* day orders and session orders) and expiring GTC (Good-'til-Canceled) orders after the close. If an option class is traded on both the SBT System during an Extended Trading Hours session and also on the Exchange during different trading hours then orders eligible to be traded in the next or a future session may be passed by the System from one book to the next appropriate book, *e.g.,* orders may be passed from the SBT Book to the regular book or from the regular book to the SBT Book as appropriate.

* * * * *

**Chapter XLIII**

*Trading Rules and Processing of Orders*

* * * * *

Matching Algorithm/Priority

Rule 43.1

(a) *Generally.* The appropriate SBT Trading Committee will determine to apply, for each class of options, one of the following rules of trading priority. The Exchange will issue a Regulatory Circular periodically which will specify which priority rules will govern which classes of options any time the appropriate Committee changes the priority.

(1) *Price-Time Priority.* Under this method, resting orders in the book are prioritized according to price and time. If there are two or more orders at the best price then priority is afforded among these orders in the order in which they were received by the SBT System.

(2) *Combined Price-Time and Size Priority.* Under this method, resting orders in the book are prioritized according to price. If there are two or more orders at the best price then trades are allocated proportionally according to size (in a pro rata fashion). The executable quantity is allocated to the nearest whole number, with fractions ½ or greater rounded up and fractions less than ½ rounded down. If there are two market participants that both are entitled to an additional ½ contract and there is only one contract remaining to be distributed, the additional contract will be distributed to the market participant whose quote or order has time priority.

(b) *Additional Priority Overlays.* In addition to the base allocation methodologies set forth above, the appropriate SBT Trading Committee may determine to apply, on a class-by-class basis, any or all of the following designated market participant overlay priorities in a sequence determined by the appropriate SBT Trading Committee. The Exchange will issue a Regulatory Circular periodically which will specify which classes of options are subject to these additional priorities as well as any time the appropriate SBT Trading Committee changes these priorities.

(1) *Public Customer.* When this priority overlay is in effect and no other priority overlays are in effect, the highest bid and lowest offer shall have priority except that public customer orders shall have priority over non-public customer orders at the same price. If other priority overlays are also in effect, priority is established in the sequence designated by the appropriate SBT Trading Committee. In either case, if there are two or more public customer orders for the same options series at the same price, priority shall be afforded to such public customer orders in the sequence in which they are received by the System, even if the Combined Price-Time and Size Priority allocation method is the chosen allocation method.

(2) *Market Turner.* When this priority overlay is in effect and no other priority overlays are in effect, the Market Turner has priority at the highest bid or lowest offer that he established. If other priority overlays are also in effect, priority is established in the sequence designated by the appropriate SBT Trading Committee. In either case, the Market Turner priority at a given price remains with the order once it is earned. For example, if the market moves in the same direction as the direction in which the order from the Market Turner moved the market, and then the market moves back to the Market Turner's original price, then the Market Turner retains priority at the original price.

(3) *Trade Participation Right.* SBT Designated Primary Market-Makers or SBT Lead Market-Makers may be granted trade participation rights pursuant to the provisions of Chapter 44 that will provide for priority over non-public customer and/or customer orders up to the applicable participation right percentage designated pursuant to the provisions of Chapter 44. If other priority overlays are also in effect, priority is established in the sequence designated by the appropriate SBT Trading Committee. In allocating the participation right, all of the following shall apply:

(i) To be entitled to their participation right, a DPM's/LMM's order and/or quote must be at the best price.

(ii) A DPM/LMM may not be allocated a total quantity greater than the quantity that the DPM/LMM is quoting (including orders not part of quotes) at that price. Additionally, a DPM/LMM may not be allocated a total quantity that represents a greater percentage than the DPM's/LMM's percentage of the total size at the best price before the participation right was applied.

(iii) If the trade participation right priority and the Market Turner priority are both in effect and the DPM/LMM is the Market Turner, the Market Turner priority will not be applicable.

(iv) In establishing the counterparties to a particular trade, the DPM's/LMM's participation right must first be counted against the DPM's/LMM's highest priority bids or offers.

(c) *Contingency Orders.* Regardless of the allocation method in place, contingency orders are placed last in priority order, regardless of when they were entered into the SBT System. A contingency order that was entered before a limit order for the same series at the same price will be treated as if it were entered after the limit order. If customer priority is afforded to a particular option class, customer contingency orders will have priority over non-public customer contingency orders but behind all other orders.

(d) *Spread Orders.* Spread orders will not be afforded priority according to this Rule 43.1 but will be handled as provided in Rule 43.10.

(e) *Regenerated Quotes.* Notwithstanding anything to the contrary in this Rule, if a Market-Maker has the SBT System regenerate his quote in accordance with Rule 44.5(b) after the Market-Maker's bid or offer has been filled, then that portion of the regenerated quote equal to the original size executed against that Market-Maker's bid or offer takes priority over all other orders at the regenerated price except public customer orders, if public customer priority is applicable to that class of options. The portion of the regenerated quote that is not executed will be placed in a priority position consistent with the time the quote was regenerated.

(f) *Cancel/Replace Orders.* Depending on how a quote or order is modified the quote or order may change priority position as follows:

(1) If the price is changed, the changed side loses position and is placed in a priority position behind all orders of the same type (*i.e.,* customer or non-customer) at the same price.

(2) If one side's quantity is changed, the unchanged side retains its priority position.

(3) If the quantity of one side is decreased, that side retains its priority position.

(4) If the quantity of one side is increased, that side loses its priority position and is placed behind all orders of the same type at the same price.

(g) *Priority of Market Orders and Limit Orders.* As further described in the Rules governing the execution of market orders and limit orders, market orders generally have execution priority over limit orders. However, if there is not a legal width market available when a market order is entered, an RFQ will be sent for the market order. During the pendency of the RFQ process, a limit order may be executed ahead of the market order if an order is entered on the other side of the market which satisfies the order's limit before any of

the conditions are satisfied that would allow the market order to trade.

* * * * *

Types of Orders Handled

Rule 43.2

(a) At the discretion of the appropriate SBT Trading Committee, and once the System is so enabled, any of the following types of orders may be accommodated on the SBT System:

(1) *Market Order.* A market order is an order to buy or sell a stated number of option contracts at the best price available in the market.

(2) *Limit order.* A limit order is an order to buy or sell a stated number of option contracts at a specified price, or better.

(3) *Cancel order.* A cancel order is an order that cancels partially or fully an existing buy or sell order.

(4) *Cancel Replace Order.* A cancel replace order is an order to cancel fully an existing buy or sell order and replace it with a new order that has a different quantity or a different price.

(5) *Day order.* A day order is an order that remains in the SBT Book until it either trades or expires at the end of the day it was entered. The System may recognize different types of day orders as indicated in Rule 43.3.

(6) *Good-for-Session order.* A Good-for-Session order remains in either the SBT Book or the auction market book until it either trades or expires at the end of the SBT Trading session or the auction market session, as appropriate. (See interpretations to Rule 43.3).

(7) *Good-'til-Canceled order.* A Good-'til-Canceled order remains in the SBT Book until either it trades, is withdrawn by the submitting trader or his firm, or the option expires. The System may recognize different types of Good-'til-Canceled orders as indicated in Rule 43.3.

(8) *Spread order.* A spread order is an order accommodated by the SBT System and as defined in the rule governing the execution of spread orders.

(9) *Contingency order.* A contingency order is a limit or market order to buy or sell that is contingent upon a condition being satisfied while the order is held in the Book for execution.

(A) *Opening Only.* An Opening Only order may be a market order or a limit order that may be accepted when the System is in the Pre-Opening, Trading Halt, and Closed States. An opening only order either will be executed on the opening or canceled.

(B) *All or None.* An all or none order is an order which is to be executed in its entirety at its limit price.

(C) *Fill-or-Kill Order.* A fill-or-kill order is an order which is to be executed in its entirety within a short period of time after its receipt. If the order is not so executed, it is canceled.

(D) *Immediate-or-Cancel Order.* An immediate-or-cancel order is a market or limit order which is to be executed in whole or in part within a short period of time after it is received by the SBT System. Any portion not so executed is to be treated as canceled.

(E) *Minimum Volume Order.* A minimum volume order is an order where the fill should at least equal the minimum volume specified, which is an amount less than the total volume of the order.

(F) *Stop (stop-loss) Order.* A stop order is an order to buy or sell when the market for a particular option contract reaches a specified price. A stop order to buy becomes a market order when the option contract trades or is bid at or above the stop price. A stop order to sell becomes a market order when the option contract trades or is offered at or below the stop price.

(G) *Stop-limit Order.* A stop-limit order is an order to buy or sell when the market for a particular option contract reaches a specified price. A stop-limit order to buy becomes a limit order when the option contract trades or is bid at or above the stop-limit price. A stop-limit order to sell becomes a limit order when the option contract trades or is offered at or below the stop-limit price.

(H) *Market-on-close Order.* A market-on-close order is a market or limit order that is to be executed during some defined period of time prior to the close and should be filled at or near to the Closing price for the particular series of option.

(10) Any other order type that the Exchange decides to permit to be entered on the SBT System.

(b) The appropriate SBT Trading Committee may determine to provide for only certain of these order types to be available during an extended trading hour session, even if these order types are available during regular trading hours. For example, the appropriate SBT Trading Committee may determine not to allow for the entry of market orders during an extended trading hour session.

* * * * *

Order Types Accepted at Various Product States

Rule 43.3

(a) The appropriate SBT Trading Committee shall determine which order types may be accepted at various product states and session states.

(b) Once the System is enabled to receive such categories of day and good 'til canceled (''GTC'') orders, customers may specify that their day orders or GTC orders are to be transferred between one trading session and the next and may determine to have the orders represented only during ETH sessions or only during auction market sessions or both. The customer may specify his preferences for the representation of his order by using codes published by the Exchange for that purpose.

* * * *Interpretations and Policies:*

.01 The Exchange will provide for the following ''time in force'' codes for orders entered over the Exchange's interface: (1) DAA—this indicates the order is to be represented only in the AM ETH session; (2) DAY—this indicates the order is to be represented only during the current Regular Trading Hour (''RTH'') session; and (3) GTC—this indicates the order is to be represented in all RTH sessions until it is traded, canceled or expired.

.02 Once the System is so enabled to recognize such codes, the Exchange will provide for the following for orders entered over the Exchange's interface: (1) DAP—this indicates the order is to be represented only in the PM ETH session; (2) DAX—this indicates the order is to be represented during all sessions during the current trading day; and (3) GTX—this indicates the order is to be represented during all sessions until it is traded, canceled, or expired.

* * * * *

Unusual Market Conditions

Rule 43.4

(a) *Fast Markets.* A fast market may be declared by (A) the SBT System automatically or (B) by two Trading Officials whenever in the judgment of those Trading Officials, due to an influx of orders or other conditions or circumstances, the interest of maintaining a fair and orderly market so requires. A ''fast market'' may be declared in one or more option classes or for the SBT System in its entirety. Once a fast market has been declared either by the SBT System or by Trading Officials, a systemwide notification message will be sent. When Trading Officials declares a fast market or when the SBT System declares a fast market, two Trading Officials may take any action the Trading Officials deem necessary to maintain a fair and orderly market including changing the bid-ask width requirement as set forth in Rule 44.4.

(1) *SBT System Declaration.* The SBT System may declare a fast market for a class or classes when the System has lost an underlying security feed, *e.g.,* SIAC or Nasdaq feed. Regular trading

conditions may be resumed when the underlying security feed has been restored or whenever a Trading Official believes that such action is warranted.

(2) *Trading Official Declaration.* In declaring a fast market, among the conditions which the Trading Officials may consider are loss of an underlying security feed, impending news, increases in trading volume that has the capability to interfere with the operation of the System, increase in volatility that has the capability to interfere with the operation of the System, and for any other reason to maintain a fair and orderly market. Regular trading conditions may be resumed whenever two Trading Officials believe that such action is warranted.

(b) *Trading Halts.* A trading halt may be declared (A) automatically by the SBT System or (B) by two Trading Officials whenever the conditions, in the Trading Officials' judgment, can not be managed by means available through the operation of paragraph (a) of this Rule.

(1) *SBT System Declaration.* With respect to stock options, the SBT System may declare a trading halt, when a trading halt has been declared for the underlying security in the primary market. When the SBT System is operated during Extended Trading Hours, there may not be a primary market trading the underlying security. In such cases, the SBT System may or may not declare a trading halt if the underlying security has been halted on one or more of the markets trading the underlying security. The appropriate SBT Trading Committee will determine in advance from time to time whether to have the system automatically halt trading on the options if the trading in the underlying has been halted in a market trading the underlying during an ETH session.

(2) *Trading Official Declaration.*

(A) With respect to options on equity securities, two Trading Officials may declare a trading halt for any of the following reasons:

(i) There was no last sale and/or quotation dissemination by the Exchange or by OPRA;

(ii) The primary market halts trading in one or more stocks for regulatory reasons;

(iii) The primary market halts trading in one or more stocks for non-regulatory reasons;

(iv) The primary market halts trading floor-wide;

(v) The primary market is open but is unable to disseminate last sale or quotation information;

(vi) Dissemination of news after or near to the close of trading in the primary market;

(vii) Opening of the underlying security has been delayed because of unusual circumstances;

(viii) Loss of the underlying security feed, *e.g.,* SIAC or NASDAQ feed;

(ix) SBT System or CBOE systems failure;

(x) Opening has not been completed or other factors affect the status of the opening;

(xi) Other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

(B) With respect to index options, two Trading Officials may declare a trading halt for any of the following reasons:

(i) Activation of price limits on future exchanges;

(ii) One or some of the stocks underlying the index is/are not trading;

(iii) The current calculation of the index derived from the current market prices of the stocks is not available;

(iv) The opening has not been completed or other factors affect the status of the opening;

(v) Other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

(C) With respect to any class of products not specified above, two Trading Officials may declare a trading halt for any unusual conditions or circumstances that the Trading Officials deem to be detrimental to the maintenance of a fair and orderly market.

(3) *Resumption of Trading.* Whenever trading has been halted, whether by the system or by the action of Trading Officials, trading may be resumed whenever two Trading Officials determine that a fair and orderly market may be maintained.

* * * * *

Trade Nullification Procedures

Rule 43.5

(a) *Negotiated Trade Nullification.* A trade on the SBT System may be nullified if the parties to the trade agree to the nullification. Negotiation may be conducted through the SBT System's messaging facility that would allow a trade party to exchange messages with his contra-parties in a particular trade. The SBT System will preserve the anonymity of the parties although a party may voluntarily disclose his identity to the other parties. When all parties to a trade have agreed to a trade nullification, one party must contact the Help Desk which will confirm the agreement and perform the following procedure:

(1) Nullify the trade in the matched trade system;

(2) notify all parties involved;

(3) disseminate cancellation information in prescribed OPRA format; and

(4) reestablish order(s) and their respective priorities in the SBT Book on a best efforts basis.

(b) *Mandated Trade Nullification.* An SBT Trader may have a trade nullified by two Trading Officials if: (i) a documented request is made within five minutes of execution or, if the request is on behalf of a public customer order, within fifteen minutes of execution; and (ii) the trade resulted from: (A) a disruption or malfunction of an Exchange execution, dissemination, or communication system; (B) an erroneous print disseminated by the underlying market which is later cancelled or corrected by that underlying market; or (C) an erroneous quote in the Primary Market (as defined in Rule 1.1) for the underlying security as defined below.

For purposes of this Rule, an erroneous quote in the Primary Market for an underlying security is a quote that has a width of at least $1.00 and has a width at least five times greater than the average quote width for such underlying security during the time period encompassing two minutes before and after the dissemination of such quote. The average quote width shall be determined by adding the quote widths of each separate quote during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).

Upon the nullification of a trade, the Help Desk will perform the following procedure:

(1) Notify all parties involved;

(2) disseminate cancellation information in prescribed OPRA format; and

(3) reestablish order(s) and their respective priorities in the SBT Book on a best efforts basis.

Nothing in this Rule should be construed to prohibit the contra-party of the trade (*i.e.,* that party who traded against the party that initiated the nullification) to seek to recover any loss incurred due to a change in the price in the underlying during the period from the trade to a reasonable amount of time (for unwinding the transaction) after the nullification notification. The recovery of any loss may be sought by any legal means including arbitration.

(c) *Reinstatement of Orders in a Nullified Trade.* All orders that were executed in a nullified trade will be reinstated along with their original entry time and price except for the following:

(1) An order of a party requesting a nullification;

(2) a market order;

(3) an order that was originally one side of a quote;

(4) a contingency order; and

(5) an order of a party who does not want the order to be reinstated.

A reinstated order is treated like any incoming order except it retains its original order entry time. If the reinstated order is the first in time priority, the order will receive market turner priority. If there is a market turner order at the same price level with lower time priority, that other order loses its market turner priority.

(d) *Spread Orders.* If so enabled, the System will provide for the possibility of nullifying trades of spread orders.

* * * * *

Order Entry and Maintenance

Rule 43.6

(a) *Spread Order Entry.* Once the SBT System is so enabled, Traders will have the ability to enter spread orders whose legs are options of the same underlying security.

(b) *Order Maintenance.* A Trader may display the status of his working or active orders (submitted to the SBT Book and SBT Spread Book, if applicable). A Trader may keep orders in the System that are inactive and may activate them when desired. A Trader may update (cancel/replace) the order; cancel the order or a group of orders; or activate or inactivate an order or a group of orders. When a Trader logs off the SBT System his orders will remain on the SBT Book or SBT Spread Book, if applicable.

(c) *Limitations on Orders.* Order providers (SBT Brokers and Proprietary Traders) will be prohibited from entering limit orders in the same options series, for the accounts or accounts of the same or related beneficial owners, in such a manner that the Order Provider or the beneficial owner(s) effectively is operating as a Market-Maker by holding itself out as willing to buy and sell options contracts on a regular or continuous basis. In determining whether an Order Provider or beneficial owner effectively is operating as a Market-Maker, the Exchange will consider, among other things: the simultaneous or near-simultaneous entry of limit orders to buy and sell the same option series during the same day; the multiple acquisition and liquidation of positions in the same option series during the same day; and the entry of multiple limit orders at different prices in the same options series.

* * * * *

Market Order Processing

Rule 43.7

(a)(1) If a legal width market exists for a particular option, even if established by a pair of unrelated bids and offers for a size less than required of SBT Market-Makers to meet their quote requirement, the SBT System will match market orders against orders at the best price in the Book and against the other orders behind the best price at varying prices until the order is fully executed or until a legal width market no longer exists.

(2) If there is not a legal width market when the order is entered in the System or if any portion of the market order is not executed because there is no longer a legal width market, then the System will hold the order (or any remaining portion of the order) in queue, send a Request for Quote (''RFQ'') to SBT Market-Makers currently providing quotes in the class (which will be handled as described in paragraph (a)(3) below), and send a notice to the originator of the order about the order status.

(3) An RFQ sent pursuant to paragraph (a)(2) will include the market order quantity, but not whether the order is a buy or a sell. RFQ responses will be sent to the SBT Book. Once the responses are sent to the SBT Book the orders may trade with resting orders unless the market order trades against that order first when one of the below conditions are met. The market order will be executed if any one of the following conditions becomes true:

(A) During the RFQ expiration response time, if the best quote width (*i.e.,* the spread between the best bid and offer) becomes a certain prescribed percentage (*e.g.,* 75%)—as set by the appropriate SBT Trading Committee—of the legal width market, the System will execute the market order against the quote and any other eligible booked order (*i.e.,* an order on the book with a limit price that allows that order to trade against the market order) until the order is filled or the legal width market no longer exists. If there is volume remaining in the market order, the System will hold the market order in queue again, send another RFQ, and send a notice to the originator about the order status.

(B)(i) If the System receives a limit order on the same side of the market as the market order that could match the best bid or offer and at least one legal width quote has been received, then the System will execute the market order against the best bid/offer. If there is no legal width quote then the limit order that is entered is filled ahead of the market order.

(ii) If one or more incoming RFQ responses could execute against a market order as well as any limit orders that are already on the book (''older limit orders'') at a particular price, then:

(aa) If the incoming RFQ response(s) is (are) of large enough quantity to fill all the older limit orders and the market order, then all those orders will be filled at the price of the older limit orders.

(bb) If the incoming RFQ response(s) is (are) not large enough to fill the market order and all the older limit orders, the market order will be executed at the minimum price interval (*i.e.,* the minimum price differential which may exist between two orders) ahead of the older limit orders.

(C) When a certain prescribed percentage of the market-makers currently providing quotes in the class (the percentage to be set by the appropriate SBT Trading Committee) (*e.g.,* 50%) have responded to the RFQ with legal width markets or when the RFQ period expires and there is at least one quote response, the System will execute the market order against orders in the SBT Book. A response will count toward the percentage requirement even if the quotes are traded against orders in the book before all orders that constitute the percentage requirement have been received. If there is volume remaining in the market order, the System will hold the order in queue and repeat the RFQ cycle again. The System will also send a notice to the originator of the order status and give him the option to cancel the order.

(4) When a market order can be executed under the conditions cited in sub-paragraphs (3)(A) through (C) above and there is one or more market orders on the opposite side, the System will cross the market orders at a price as determined as follows:

(A) At the middle of the best bid-offer in the Book if the middle price is a legal price; or

(B) If the middle price is not a legal price, at the next legal price from the middle that is closer to the last trade price of the series.

(C) For purposes of this sub-paragraph (a)(4), ''legal price'' means a price that may be entered on the SBT System.

(b) If the RFQ period expires and there is no RFQ response, the System will continue to hold the market order, repeat the RFQ cycle, send a notice to the originator of the order, and send an

alert message to the Help Desk so that the Help Desk may solicit quotes from the market-makers. The Help Desk may require a response from the Market-Makers.

(c) If a market order for a certain series becomes subject to an RFQ as described in paragraph (a) above, then subsequent market orders for the same series and side are queued to ensure that these incoming market orders are processed in time sequence. Market orders for the same series but opposite side would be processed normally. Other orders that are not market orders would be routed to the SBT Book.

(d) *Trading Halts.* When trading is halted in the series while a market order is on hold waiting for RFQ responses, the SBT System will do the following: If the market order is a GTC order, the System will hold and execute it at the next opening, in the same day or the next day. If it is a day order, the System executes it at re-opening if trading resumes for the same day. If trading does not resume, the System purges it as part of the end-of-day procedure for purging day orders.

* * * * *

Processing of Limit Orders

Rule 43.8

Until the System is enabled to provide price protection as set forth in Rule 43.8A, after the opening, upon being entered into the SBT System, limit orders will be matched against the best prices available in the SBT Book under the priority rules set forth in Rule 43.1. If there are no orders in the SBT Book that match the limit order when it is entered, the limit order will be held and displayed in the SBT Book and may be traded against later submitted orders.

* * * * *

Price Protection of Limit Orders

Rule 43.8A

(a) When the System is so enabled, and to the extent that the appropriate SBT Trading Committee has determined to apply the protection to the particular options class, the System will protect a limit order by automatically executing it against the best bid/ask only if one or both of the following conditions is met:

(1) A legal width market exists for that series; or

(2) The limit price on the order is between the bid of the series with the same expiration month and one strike price lower and the offer of the series with the same expiration month and one strike price higher and a legal width market exists for both of these series.

(b) If a limit order can execute against the best bid/ask and neither of the conditions set forth in paragraph (a)(1) or (a)(2) is met, the System puts the order in queue and sends an RFQ. The RFQ will include the order quantity but not whether the order is a buy or sell. Quote responses are exposed in the SBT Book as they are received. The SBT Trader whose link to the SBT System is through the API and who has submitted the limit order may override the RFQ and determine to enter the limit order into the SBT Book.

(c) If the limit order's price prevents it from matching with the best bid/ask, the System will place the order in the Book in its appropriate priority position.

(d) If the submitting SBT Trader does not override the RFQ pursuant to paragraph (b), the System will execute the limit order after one of the following conditions becomes true:

(1) During the RFQ response time, if the best quote width becomes a certain prescribed percentage (*e.g.,* 75%)—as set by the appropriate SBT Trading Committee—of a legal width market, the System shall execute the limit order against the quote and any other eligible Booked order. If there is volume remaining in the limit order, the System will hold the limit order in the SBT Book and send a notice to the originator about the order status.

(2) If an incoming market or limit order is received (independent of the RFQ responses) on the opposite side that would match the original limit order and if a legal width market exists for the series, then the System will match the limit order with the best bid/ask. If there is volume remaining in the limit order, the System will hold the limit order in the SBT Book.

(3) When a certain prescribed percentage of the SBT Market-Makers currently providing quotes in that class (the percentage to be set by the appropriate SBT Trading Committee), have responded to the RFQ or when the RFQ period expires and there is at least one quote response, the System will execute the limit order against the SBT Book. If there is volume remaining in the limit order, the System will hold it in the SBT Book. The System will also send a notice to the originator of the order status and give him the option to cancel the order.

(e) If a limit order for a certain series is queued, subsequent limit orders for the same series and side are queued behind the first one to ensure that they are processed in time sequence. Market orders for the same series and side also will be queued. If a legal width market remains upon completion of the limit order processing the market order will be executed against orders resting in the Book. If there is not a legal width market, market order processing will begin in accordance with Rule 43.7.

* * * * *

Processing of Contingency Orders

Rule 43.9

Contingency orders will be handled by the SBT System as described below. As described in Rule 43.2, for purposes of determining priority, a contingency order that is entered before a limit order with no contingency at the same price and for the same series will nonetheless be treated as if it were entered after the limit order. The SBT System will notify the originator of the order if the contingency order expires or is canceled. Contingency orders except Immediate or Cancel orders will not be disseminated as part of the best bid/ask to OPRA. The SBT System may disseminate to certain SBT Traders a contingency count that includes All or None, Fill or Kill, and Minimum Volume order information. The following contingency orders will be handled by the SBT System as described below once the SBT System is so enabled to handle such contingency orders.

(a) *Opening Only Order.* The order will be executed during the Opening State if there are orders to execute it against. The order or any unexecuted portion will expire after the opening trade or after the opening quote is disseminated.

(b) *All or None Order.* An all or none (''AON'') order will only be executed if it can be executed in its entirety. The order will remain in the Book until filled or canceled.

(c) *Fill or Kill Order.* A fill or kill (''FOK'') order has a time contingency and must be fully filled within a period of time, or the System automatically cancels the order. The SBT System will attempt to execute the full quantity of the FOK order upon receipt. If the FOK order is at the best price, and there is a legal width market, and it cannot be filled fully, the System will indicate its presence to certain SBT Traders by disseminating its quantity for the Time Contingency Period (*e.g.,* five seconds) as determined by the appropriate SBT Trading Committee. If the FOK order does not equal or better the market, *e.g.,* if it is a buy order lower than the best bid or a sell order higher than the best offer, the System will reject the order.

(d) *Immediate or Cancel Order.* An Immediate or Cancel (''IOC'') order has a time contingency and must be filled fully or partially within a period of time, or the System automatically cancels the remainder. If the IOC order is at the best price, and there is a legal

width market, and it cannot be filled fully, the System will indicate its presence to certain SBT Traders by disseminating its quantity for the Time Contingency Period as determined by the appropriate SBT Trading Committee. If the IOC order does not equal or better the market, *e.g.,* if it is a buy order lower than the best bid or a sell order higher than the best offer, the System will reject the order. The SBT System will cancel the residual order volume after the Time Contingency Period, if the IOC order has not been executed completely.

(e) *Minimum Volume Order.* A Minimum Volume (''MIN'') order may be accepted by the SBT System at any time. The MIN order has two quantities specified: the total quantity and the minimum acceptable quantity that can be filled. The fill must be at least equal to the minimum quantity specified. The SBT System will attempt to execute at least the minimum volume specified against orders in the Book. If the minimum volume is not executed, the order will remain in the Book.

(f) *Stop Order.* A Stop order to buy becomes a market order when the product trades or is bid at or above the stop price. A Stop order to sell becomes a market order when the product trades or is offered at or below the stop price.

(g) *Stop Limit Order.* A Stop Limit order has two prices, the stop-limit price and the limit price. A stop-limit order to buy becomes a limit order at the second price when the product trades or is bid at or above the stop-limit price (first price). A stop-limit order to sell becomes a limit order at the second price when the product trades or is offered at or below the stop-limit price (first price).

(h) *Market On Close Order.* A Market on Close (''MOC'') order may be received at any time up to some period of time before the closing period (*e.g.,* four minutes before the close) and is executable only during a pre-defined period of time prior to the close (*e.g.,* two minutes prior to the close). When an MOC order is present, the System will send an RFQ for it at a pre-defined time before the close; the time before the close to be determined by the appropriate SBT Trading Committee. The order is canceled after closing if it is not filled.

* * * * *

Processing of Spread Orders

Rule 43.10

(a) When the System is so enabled, the System will support the following types of spread orders (''Spread Orders''): (1) two-legged spreads where the ratio is 1:1 and 1:2; (2) three-legged spreads where the ratio is 1:1:1 or 1:2:1; (3) four-legged spreads where the ratio is 1:1:1:1; and (4) any spread type approved by the appropriate SBT Trading Committee.

(b) The System will treat each spread order as a unique product and will assign each a unique product name. Data about the resulting spread product will be disseminated at the point of creation to all SBT Traders. The System will maintain a Book for every unique spread, with bids and offers for individual spread packages. The System will keep track of and disseminate the best bid and offer for every unique spread.

(c) An SBT Trader submitting a spread order may change the net price, the multiplier or the quantity of the spread, the time in force, and any contingency.

(1) An increase in the multiplier or quantity changes the order's priority;

(2) A decrease in the multiplier or quantity does not change its priority position;

(d) A spread order may trade only if all of its legs have legal width markets and if only one leg trades at a price ahead of orders in the Book at the same price.

(e) When the spread is traded, the System will do the following:

(1) Disseminate to the order source the fill report for the spread, but not the individual legs;

(2) Disseminate to the designated back office the fill reports for the individual legs; and

(3) Disseminate the last sale reports to OPRA (or any other securities information processor that is being employed by the Exchange) for the individual legs, with some indication that the last sale is part of a spread trade.

* * * * *

Processing of Requests for Quotes

Rule 43.11

(a) *Submission of RFQs.*

(1) Any SBT Trader may initiate a Request for Quote (RFQ) for a series. The SBT Trader may specify a size at his option. The System will send the RFQ to the Market Makers who are currently providing quotes in that class.

(2) The SBT System will also automatically send an RFQ when the SBT System receives a market order and the current market width is wider than the Exchange prescribed width as set forth in Rule 44.4.

(b) *Response to RFQs.* RFQs may be submitted by an SBT Trader or an RFQ may be initiated by the System as otherwise described in the Rules. In either event, the RFQ has an expiration period for the Market-Makers to respond to the RFQ. Market-Makers must respond to RFQs in accordance with their obligations set forth in Rule 44.4(b).

(c) *Processing of RFQ Responses.* RFQ responses (quotes) are submitted to the Book and exposed as they arrive.

* * * * *

Crossing Trades

Rule 43.12

(a) *Crossing Mechanism.* Once the System is so enabled to provide for it, the Crossing Mechanism is a process by which an SBT Broker can facilitate orders or cross two orders.

(1) An SBT Broker must submit to the System an RFQ designating a size equal to the quantity to be crossed.

(2) SBT Traders will have an RFQ response period for a length of time established by the SBT Trading Committee in order to enter orders or quotes that improve upon the market.

(3) Within a time period after the RFQ was sent, with such time period to be established by the SBT Trading Committee, the terms of the cross transaction have to be entered. The required terms include the terms of the original order and the proposed facilitation order (or two original orders), a proposed crossing price, the quantity of the original order which the SBT Broker is willing to facilitate (in the case of a facilitation cross), and an indication of which order is to be exposed to the market (in the case of cross of two original orders). The customer order will be the exposed order in a facilitation cross.

(4) The following two conditions must be satisfied at the time the cross transaction is entered or the System will reject the cross transaction: (A) a legal width market must exist for the particular series to be crossed and (B) the proposed cross price must be between the best bid and offer displayed by the System.

(5) After accepting the cross transaction, the System will immediately cross the two orders for the guaranteed crossing percentage (which is established at 40%) of the overall crossing quantity. The System exposes the remaining volume of the designated order in the book for a crossing period of twenty seconds. The order's price and the remaining quantity are disclosed but there is no indication that the order is part of an impending cross. The System places the opposite order on hold as a shadow order that is not visible except to the submitter.

(6) As long as the exposed order is the highest priority order at the best price, other SBT Traders can trade against the exposed order during the crossing period. If the exposed order is fully filled by other traders, the System cancels the remaining quantity of the shadow order and sends the SBT Broker a message that the crossing transaction is completed.

(7) At the end of the crossing period (if the order has not yet been fully traded), if the exposed order is at the best price and has the highest priority, then the System fills the remainder of the order against the shadow order. The System cancels the remainder of the shadow order and sends the crossing firm a message that the crossing transaction is completed. If the exposed order has quantity remaining and it is not the highest priority order at the market, then the System automatically cancels the remainder of the exposed order and the shadow order and sends the SBT Broker a message that the crossing transaction is completed.

(b) Rule 43.12A will apply until the System is so enabled to provide for this Crossing Mechanism.

* * * * *

Interim Crossing Procedure

Rule 43.12A

(a) An SBT Broker who wishes to cross two original orders or to facilitate an original order must first send an RFQ with the size of the orders to be crossed. The RFQ response period will be established by the appropriate SBT Trading Committee and shall initially be set at thirty seconds.

(b) At the end of this RFQ response period and within twenty seconds or some other period of time established by the appropriate SBT Trading Committee, the SBT Broker must expose one of the orders to the Book.

(c) If the exposed order has not been completely taken out by other SBT Traders at the end of a period after the order was entered, then the SBT Broker may enter the opposite order to cross the balance of the exposed order. The period of time shall be established by the appropriate SBT Trading Committee and shall initially be set at ten seconds.

* * * * *

Prohibited Conduct Related to Cross Transactions

Rule 43.12B

(a) It will be a violation of Rule 43.12 and of Rule 43.12A for an SBT Broker to be a party to any arrangement designed to circumvent Rule 43.12 or Rule 43.12A by providing an opportunity for a customer to regularly execute against agency orders handled by the SBT Broker immediately upon their entry into the System.

(b) It will be a violation of Rule 43.12 or of Rule 43.12A for an SBT Broker to cause the execution of an order it represents as agent on the Exchange by orders it solicited from Members and non-member broker-dealers to transact with such orders, whether such solicited orders are entered into the System directly by the SBT Broker or by the solicited party (either directly or through another Member), if the Member fails to expose orders on the Exchange as required by Rule 43.12 or Rule 43.12A.

* * * * *

Responsible Traders

Rule 43.13

(a) *Defined.* A Responsible Trader is an individual who is responsible for each and every order submitted to the SBT System on behalf of a particular SBT Trader. There must be a Responsible Trader registered with the Exchange for every member. The Responsible Trader must be approved by the Membership Committee and must satisfy any qualification standards set by the Exchange.

(b) The Responsible Trader will be required to:

(1) have full control over access to the SBT System and over the ability to submit orders using the member's access right;

(2) be fully aware of orders submitted using the member's access right (although the business might have originated from another source); and

(3) have the ability to adjust or withdraw any order.

(c) A Responsible Trader can be charged for violations of Exchange rules resulting from any submission of an order made on behalf of the particular member.

* * * * *

**Chapter XLIV—SBT Market-Makers and Designated Market-Makers**

* * * * *

*Section A: Market-Makers*

* * * * *

SBT Market-Maker Defined

Rule 44.1

An SBT Market-Maker for purposes of the rules in Chapter XL through LIX is an individual (either a member or nominee of a member organization or a member who has registered his or her membership for a member organization) who is registered with the Exchange for the purpose of making transactions as a dealer-specialist in the SBT System in accordance with the provisions of this Chapter. Registered SBT Market-Makers are designated as specialists on the Exchange for all purposes under the Securities Exchange Act of 1934 and the Rules and Regulations thereunder. Only transactions that are (i) transacted on the SBT System or (ii) that qualify under Rule 8.1 shall count as Market-Maker transactions for purposes of this Chapter and Rules 8.1 and 12.3(b)(2). An SBT Market-Maker may be either: an SBT Standard Market-Maker, an SBT Lead Market-Maker or an SBT Designated Primary Market-Maker.

* * * * *

Registration of Market-Makers

Rule 44.2

(a) An applicant for registration as an SBT Market-Maker shall file his application in writing with the Membership Department on such form or forms as the Exchange may prescribe. Applications shall be reviewed by the Membership Committee, which shall consider an applicant's ability as demonstrated by his passing an examination prescribed by the Exchange, and such other factors as the Committee deems appropriate. After reviewing the application, the Committee shall either approve or disapprove the applicant's registration as an SBT Market-Maker.

(b) The registration of any person as an SBT Market-Maker may be suspended or terminated by the appropriate Market Performance Committee upon a determination that such person has failed to properly perform as an SBT Market-Maker.

(c) Any member or prospective member adversely affected by a determination of the appropriate Market Performance Committee under this Rule may obtain a review in accordance with the provisions of Chapter XIX.

* * * * *

Appointment of SBT Market-Makers

Rule 44.3

(a) On a form or forms prescribed by the Exchange, a registered SBT Market-Maker may apply for an Appointment (having the obligations of Rule 44.4) in one or more classes of option contracts traded on the SBT System. From among those SBT Market-Makers registered, the appropriate Market Performance Committee shall ordinarily make two or more Appointments for each class of option contracts traded on the System. In making such Appointments, the Committee shall give attention to (1) the preference of registrants; (2) the maintenance and enhancement of

competition among SBT Market-Makers in each class of options; and (3) assuring that financial resources available to an SBT Market-Maker enable him to satisfy the obligations set forth in Rule 44.4 with respect to each class of option contracts to which he is appointed. The appropriate Market Performance Committee may arrange two or more classes of options into groupings and make Appointments to those groupings rather than to individual classes. The appropriate Market Performance Committee may suspend or terminate any Appointment of an SBT Market-Maker under this Rule and may make additional Appointments whenever, in the Committee's judgment, the interests of a fair and orderly market are best served by such action.

(b) An SBT Market-Maker's refusal to accept an Appointment may be deemed sufficient cause for termination or suspension of an SBT Market-Maker's registration.

(c) The appropriate Market Performance Committee may limit the number of classes which an SBT Market-Maker may trade outside of his Appointment either on the floor of the Exchange or on the SBT System on a daily basis or for some other designated period of time. Unless exempted by the appropriate Market Performance Committee, to the extent an SBT Market-Maker trades in an option class outside his Appointment, that SBT Market-Maker becomes subject to the requirements of Rule 44.4 for that option class for that day or for a designated period as determined by the appropriate Market Performance Committee.

(d) The appointment of an SBT Market-Maker to an option class traded on the System will not count against that Member's limit of ten trading stations to which that Member may be appointed pursuant to Rule 8.3(c).

* * * *Interpretations and Policies:*

.01 SBT Lead Market-Makers. A member organization desiring to be approved to act as an SBT LMM shall file an application with the Exchange on such form or forms as the Exchange may prescribe. The appropriate Market Performance Committee may appoint one or more SBT LMMs to an option class traded on the System if those option classes have not been assigned to an SBT DPM. If the appropriate Market Performance Committee appoints more than one SBT LMM per trading session to an option class traded on the System, the appointed SBT LMMs will function as SBT LMMs on a rotating basis in accordance with a schedule set by the appropriate Market Performance Committee. SBT LMMs will have the obligations of SBT Market-Makers plus those additional obligations set forth in Interpretation .01 to Rule 44.4.

* * * * *

Obligations of SBT Market-Makers

Rule 44.4

(a) *General.* Transactions of an SBT Market-Maker should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no SBT Market-Maker should enter into transactions or make bids or offers that are inconsistent with such a course of dealings.

(b) *RFQ Response.* With respect to each class of option contracts for which he holds an Appointment under Rule 44.3 and for any other classes that he trades as required by Rule 44.3(c), an SBT Market-Maker has an obligation to respond to that percentage of RFQs as determined by the appropriate Market Performance Committee with a two-sided market at or within the widths prescribed in the table below within the amount of time specified by the appropriate Market Performance Committee from the time the RFQ is entered. The SBT Market-Maker shall specify the size at which he is willing to trade the series. The size shall not be less than a minimum specified by the appropriate Market Performance Committee. The SBT Market-Maker responding to the RFQ is required to maintain a continuous market in that series for a subsequent 30-second period (or for some other time specified by the appropriate Market Performance Committee) or until his quote is filled. An SBT Market-Maker may change his quotes during this subsequent 30-second period but he may not cancel them without replacing them. If the SBT Market-Maker does cancel without replacing the quote his response to the RFQ will not count toward the SBT Market-Maker's percentage requirement set forth in this paragraph (b). An SBT Market-Maker will be considered to have responded to the RFQ if he has a quote in the market for the series at the time the RFQ is received and he maintains it for the appropriate period of time. An SBT Market-Maker must respond to a percentage, to be established by the appropriate Market Performance Committee, of the Special RFQs that the SBT Market-Maker is sent. The bid/ask differentials listed in the table below shall not apply to in-the-money series where the underlying securities market is wider than the widths set forth below. For those series, the bid/ask differential may be as wide as the quotation on the primary market of the underlying security.

| Bid range | Maximum allowable quote spread |
|---|---|
| Less than $2.00 | $0.25 |
| $2.00–$5.00 | 0.40 |
| $5.01–$10.00 | 0.50 |
| $10.01–$20.00 | 0.80 |
| $20.01–higher | 1.00 |

(c) *Classes of Option Contracts Other than those to which Appointed.* With respect to classes of option contracts in which he does not hold an Appointment, an SBT Market-Maker should not engage in transactions for an account in which he has an interest which are disproportionate in relation to, or in derogation of, the performance of his obligations as specified in paragraph (b) of this Rule with respect to those classes of option contracts to which he does hold an Appointment. Whenever an SBT Market-Maker submits a two-sided quote in an option class to which he is not appointed, he must fulfill the obligations established by paragraph (b) of this Rule for the rest of that trading session.

(d) *Obligations during an ETH Session.* Depending upon the liquidity in any of the underlying markets during an ETH session, the appropriate Market Performance Committee may determine not to impose an RFQ response requirement upon SBT market-makers or may impose a different RFQ response rate than is applicable during the regular trading hours.

(e) *Exemptions.* The appropriate Market Performance Committee may establish bid/ask widths different than those specified above for one or more option series. The appropriate Market Performance Committee may also vary the RFQ response rate on a series-by-series basis. Two Trading Officials may also vary the bid/ask differences or the RFQ response rate in the event of unusual market conditions

* * * *Interpretations and Policies:*

.01 SBT Lead Market-Makers.

(a) Each SBT LMM shall fulfill all of the obligations of an SBT Market-Maker under the Rules, and shall satisfy each of the following requirements, in respect of each of the securities appointed to the SBT LMM, during such SBT LMM's rotation(s) as an LMM:

(1) Assure that its disseminated market quotations are accurate;

(2) provide opening quotes for all series in its appointed classes;

(3) trade in all securities appointed to the SBT LMM only in the capacity of an

SBT LMM and not in any other capacity;

(4) handle orders that are not executed on the System due to the fact that there is a better quote on another market;

(5) respond to a percentage of the RFQs at a rate as designated by the appropriate Market Performance Committee. The appropriate Market Performance Committee may also require that an SBT LMM provide continuous quotes in some or all of the series of the classes appointed to an SBT LMM; and

(6) supervise all persons associated with the SBT LMM to assure compliance with the Rules.

(b) Subject to the review of the Board of Directors, the appropriate Market Performance Committee may establish from time to time a participation entitlement formula that is applicable to all SBT LMMs. The maximum guaranteed percentage entitlement for an SBT LMM shall be 40%, although the participation of an SBT LMM on any particular trade may be greater if the applicable allocation and priority rules provide for a pro rata distribution. To the extent established pursuant to this paragraph and pursuant to the applicable trading allocation and priority rules, each SBT LMM shall have a right to participate for its own account with the other SBT Traders in transactions in securities appointed to the SBT LMM that occur at the SBT LMM's previously established bid or offer whether the bid or offer was established by a quote or an order. The appropriate Market Performance Committee may determine whether the participation entitlement shall be applicable to the opening transaction.

* * * * *

Quote Maintenance

Rule 44.5

(a) *Generally.* An SBT Market-Maker will have the following functional capabilities for maintaining his quotes in the SBT Book:

(1) An SBT Market-Maker may delete or cancel a specific quote;

(2) An SBT Market-Maker may delete or cancel all of his quotes in a specified class, or all of his quotes in all classes;

(3) An SBT Market-Maker may inactivate his quotes for a certain period of time, if the System is so enabled; and

(4) An SBT Market-Maker may cancel/replace or update an existing quote.

(b) *Automatic Quote Regeneration.* Once the System is so enabled to provide this function, an SBT Market-Maker may have the SBT System regenerate his quote when his bid or offer is filled. The SBT System will regenerate a new quote where the bid/offer is a pre-defined number of ticks worse than the previous bid/offer (the number of ticks will be defined by the SBT Market-Maker) and the size of the quote will be set by the SBT Market-Maker. The priority of the regenerated quote will be as described in Rule 43.1(e). When a bid/offer is regenerated the designated number of ticks worse than the previous bid/offer, the SBT System will keep the opposite side at the same price unless the resulting spread is wider than the Exchange prescribed width as set forth in Rule 44.4. If the resulting spread would be wider, then the SBT System will adjust the opposite side's price (cancel/replace the old order) (i) to keep the same spread before the regeneration, or (ii) adjust it to bring the spread to the Exchange prescribed width, as determined by the SBT Market-Maker.

(c) *Quote Risk Monitor Function.* The SBT System will provide for an SBT Market-Maker to establish a contract volume limit for a class for a period of time designated by the SBT Market-Maker. If trades against an SBT Market-Maker's quotes in that class exceed the established volume limit within the designated period of time (*e.g.,* 200 contracts within the most recent ten second period), then the SBT System will cancel the SBT Market-Maker's remaining quotes for that class. The appropriate Market Performance Committee may establish minimum volume limits and minimum time periods for all SBT Market-Makers. The System will not consider trades the SBT Market-Maker initiates by hitting a bid or taking an offer in determining whether the volume limit is exceeded.

(d) *Managing Quote Traffic.* The Exchange may set limits on the quote traffic that is sent to the SBT System to prevent the SBT System from becoming overloaded.

(e) *Logoff.* An SBT Market-Maker's logoff from the SBT System will cause the System to delete all his quotes from the SBT Book. Non-quote orders will remain in the Book unless they are expiring orders.

* * * * *

Market-Making through an API

Rule 44.6

The Exchange may limit the number of Market-Makers that may access the SBT System through an API (or the number of messages sent by Market-Makers accessing the System through an API) in order to protect the integrity of the System. In addition, the Exchange may impose restrictions on the use of a computer connected through an API if it believes such restrictions are necessary to ensure the proper performance of the System.

* * * * *

Rule 44.7–44.9 Reserved

* * * * *

*Section B: SBT Designated Primary Market-Makers*

* * * * *

SBT DPM Defined

Rule 44.10

An ''SBT Designated Primary Market-Maker'' or ''SBT DPM'' is a member organization that is approved by the Exchange to function on the SBT System in allocated securities as an SBT Market-Maker (as defined in Rule 44.1) with the additional obligations provided for in this Section B of Chapter 44. Determinations concerning whether to grant or withdraw the approval to act as an SBT DPM are made by the appropriate SBT DPM Appointments Committee (''SBT DPM Committee'') in accordance with Rules 44.12. SBT DPMs are allocated securities by the appropriate Allocation Committee in accordance with Rule 8.95.

* * * * *

SBT DPM Designees

Rule 44.11

(a) An SBT DPM may act as an SBT DPM solely through its SBT DPM Designees. An ''SBT DPM Designee'' is an individual who is approved by the SBT DPM Committee to represent an SBT DPM in its capacity as an SBT DPM. The SBT DPM Committee may subclassify SBT DPM Designees and require that certain SBT DPM Designees be subject to specified supervision and/or be limited in their authority to represent a SBT DPM.

(b) Notwithstanding any other rules to the contrary, an individual must satisfy the following requirements in order to be an SBT DPM Designee of an SBT DPM:

(1) The individual must be a member of the Exchange;

(2) the individual must be a nominee of the SBT DPM or of an affiliate of the SBT DPM or must own a membership that has been registered for the SBT DPM or for an affiliate of the SBT DPM;

(3) the individual must be registered as an SBT Market-Maker pursuant to Rule 44.1;

(4) on such form or forms as the Exchange may prescribe, the SBT DPM must authorize the individual to enter into Exchange transactions on behalf of the SBT DPM in its capacity as an SBT

DPM, must authorize the individual to represent the SBT DPM in all matters relating to the fulfillment of the SBT DPM's responsibilities as an SBT DPM, and must guaranty all obligations arising out of the individual's representation of the SBT DPM in its capacity as an SBT DPM in all matters relating to the Exchange; and

(5) the individual must be approved by the SBT DPM Committee to represent the SBT DPM in its capacity as an SBT DPM.

Notwithstanding the provisions of sub-paragraph (b)(2) of this Rule, the SBT DPM Committee shall have the discretion to permit an individual who is not affiliated with an SBT DPM to act as an SBT DPM Designee for the SBT DPM on an emergency basis provided that the individual satisfies the other requirements of sub-paragraph (b) of this Rule.

(c) The approval of an individual to act as an SBT DPM Designee shall expire in the event the individual does not have trading privileges on the Exchange for a six month time period.

(d) An SBT DPM Designee of an SBT DPM may not trade as a Market-Maker in securities allocated to the SBT DPM unless the SBT DPM Designee is acting on behalf of the SBT DPM in its capacity as an SBT DPM.

* * * * *

Approval To Act as an SBT DPM

Rule 44.12

(a) A member organization desiring to be approved to act as an SBT DPM shall file an application with the Exchange on such form or forms as the Exchange may prescribe.

(b) The SBT DPM Committee shall determine the appropriate number of approved SBT DPMs. Each SBT DPM approval shall be made by the SBT DPM Committee from among the SBT DPM applications on file with the Exchange, based on the SBT DPM Committee's judgment as to which applicant is best able to perform the functions of an SBT DPM. Factors to be considered in making such a selection may include, but are not limited to, any one or more of the following:

(1) Adequacy of capital;

(2) operational capacity;

(3) trading experience of and observance of generally accepted standards of conduct by the applicant, its associated persons, and the SBT DPM Designees who will represent the applicant in its capacity as an SBT DPM;

(4) number and experience of support personnel of the applicant who will be performing functions related to the applicant's SBT DPM business;

(5) regulatory history of and history of adherence to Exchange Rules by the applicant, its associated persons, and the SBT DPM Designees who will represent the applicant in its capacity as an SBT DPM;

(6) willingness and ability of the applicant to promote the Exchange as a marketplace;

(7) performance evaluations conducted pursuant to Exchange rules; and

(8) in the event that one or more shareholders, directors, officers, partners, managers, members, SBT DPM Designees, or other principals of an applicant is or has previously been a shareholder, director, officer, partner, manager, member, SBT DPM Designee, DPM Designee, or other principal in another SBT DPM or DPM, adherence by such SBT DPM to the requirements set forth in Exchange rules regarding DPM or SBT DPM responsibilities and obligations during the time period in which such person(s) held such position(s) with the SBT DPM or DPM.

(c) Each applicant for approval as an SBT DPM will be given an opportunity to present any matter which it wishes the SBT DPM Committee to consider in conjunction with the approval decision. The SBT DPM Committee may require that a presentation be solely or partially in writing, and may require the submission of additional information from the applicant or individuals associated with the applicant. Formal rules of evidence shall not apply to these proceedings.

(d) In selecting an applicant for approval as an SBT DPM, the SBT DPM Committee may place one or more conditions on the approval, including, but not limited to, conditions concerning the capital, operations, or personnel of the applicant and the number or type of securities which may be allocated to the applicant.

(e) Each SBT DPM shall retain its approval to act as an SBT DPM until the SBT DPM Committee relieves the SBT DPM of its approval and obligations to act as an SBT DPM or the SBT DPM Committee terminates the SBT DPM's approval to act as an SBT DPM.

(f) If a member organization resigns as an SBT DPM or if the SBT DPM Committee terminates or otherwise limits its approval to act as an SBT DPM, the SBT DPM Committee shall have the discretion to do one or both of the following:

(1) Approve an interim SBT DPM, pending the final approval of a new SBT DPM pursuant to paragraphs (a) through (d) of this Rule; and

(2) allocate on an interim basis to another SBT DPM or to other SBT DPMs the securities that were allocated to the affected SBT DPM, pending a final allocation of such securities pursuant to Rule 8.95.

Neither an interim approval or allocation made pursuant to this paragraph (f) should be viewed as a prejudgment with respect to the final approval or allocation.

* * * * *

Conditions on the Allocation of Securities to SBT DPMs

Rule 44.13

The SBT DPM Committee may establish (i) restrictions applicable to all SBT DPMs on the concentration of securities allocable to a single SBT DPM and to affiliated SBT DPMs and (ii) minimum eligibility standards applicable to all SBT DPMs which must be satisfied in order for an SBT DPM to receive allocations of securities, including but not limited to standards relating to adequacy of capital and number of personnel.

* * * * *

Termination, Conditioning, or Limiting Approval to Act as a DPM

Rule 44.13A

(a) The SBT DPM Committee may terminate, place conditions upon, or otherwise limit a member organization's approval to act as an SBT DPM under any one or more of the following circumstances:

(1) If the member organization incurs a material financial, operational, or personnel change;

(2) if the member organization fails to comply with any of the requirements under this Section B of Chapter XLIV or the applicable provisions of Section B of Chapter VIII or fails to adequately satisfy the standards of performance under Rule 8.88(a);

(3) if for any reason the member organization should no longer be eligible for approval to act as a DPM or to be allocated a particular security or securities.

Before the MTS Committee takes action to terminate, condition, or otherwise limit a member organization's approval to act as an SBT DPM, the member organization will be given notice of such possible action and an opportunity to present any matter which it wishes the MTS Committee to consider in determining whether to take such action. Such proceedings shall be conducted in the same manner as SBT DPM Committee proceedings concerning SBT DPM approvals which are governed by Rule 44.12(c).

(b) Notwithstanding the provisions of paragraph (a) of this Rule, the SBT DPM

Committee has the authority to immediately terminate, condition, or otherwise limit a member organization's approval to act as an SBT DPM if it incurs a material financial, operational, or personnel change warranting such action or if the member organization fails to comply with any of the financial requirements of Rule 8.86.

(c) Limiting a member organization's approval to act as an SBT DPM may include, among other things, limiting or withdrawing the member organization's SBT DPM participation entitlement provided for under Rule 44.15, withdrawing the right of the member organization to act in the capacity of an SBT DPM in a particular security or securities which have been allocated to the member organization, and/or requiring the relocation of the member organization's SBT DPM operation on the Exchange's trading floor.

(d) If a member organization's approval to act as an SBT DPM is terminated, conditioned, or otherwise limited by the SBT DPM Committee pursuant to this Rule, the member organization may seek review of that decision under Chapter XIX of the Rules.

* * * * *

SBT DPM Obligations

Rule 44.14

(a) Each SBT DPM shall fulfill all of the obligations of an SBT Market-Maker under the Rules, and shall satisfy each of the following requirements, in respect of each of the securities allocated to the DPM:

(1) Assure that its disseminated market quotations are accurate;

(2) Provide opening quotes for all series in its allocated classes;

(3) Trade in all securities allocated to the SBT DPM only in the capacity of an SBT DPM and not in any other capacity;

(4) Handle orders that are not executed on the System due to the fact that there is a better quote on another market;

(5) Respond to a percentage of the RFQs at a rate as designated by the appropriate Market Performance Committee. The appropriate Market Performance Committee may also require that an SBT DPM provide continuous quotes in some or all of the series of the classes assigned to an SBT DPM; and

(6) Segregate in a manner prescribed by the appropriate SBT DPM Committee (A) all transactions consummated by the SBT DPM in securities allocated to the SBT DPM and (B) any other transactions consummated by or on behalf of the SBT DPM that are related to the SBT DPM's DPM business.

To the extent that there is any inconsistency between the specific obligations of an SBT DPM set forth in sub-paragraphs (a)(1) through (a)(5) of this Rule and the general obligations of an SBT Market-Maker under the Rules, sub-paragraphs (a)(1) through (a)(5) of this Rule shall govern.

(b) *Other Obligations.* In addition to the obligations described in paragraph (a) of this Rule, an SBT DPM shall fulfill each of the following obligations:

(1) Act to increase the Exchange's order flow in the securities which are allocated to the SBT DPM and respond to competitive developments by improving market quality and service and otherwise acting to increase the Exchange's market share in those securities;

(2) Promptly inform the SBT DPM Committee of any desired change in the SBT DPM Designees who represent the SBT DPM in its capacity as an SBT DPM and of any material change in the financial or operational condition of the SBT DPM;

(3) Supervise all persons associated with the SBT DPM to assure compliance with the Rules;

(4) Continue to act as an SBT DPM and to fulfill all of the SBT DPM's obligations as an SBT DPM until the SBT DPM Committee relieves the SBT DPM of its approval and obligations to act as an SBT DPM or the SBT DPM Committee terminates the SBT DPM's approval to act as an SBT DPM; and

(5) Segregate in a manner prescribed by the appropriate SBT DPM Committee the SBT DPM's business and activities as an SBT DPM from the SBT DPM's other business and activities.

(c) *Obligations of SBT DPM Associated Persons.* Each person associated with an SBT DPM shall be obligated to comply with the provisions of this Rule when acting on behalf of the SBT DPM.

* * * * *

Participation Entitlement of SBT DPMs

Rule 44.15

(a) Subject to the review of the Board of Directors, the SBT DPM Committee may establish from time to time a participation entitlement formula that is applicable to all SBT DPMs. The maximum guaranteed percentage entitlement for an SBT DPM shall be 40%, although the participation of an SBT DPM on any particular trade may be greater if the applicable allocation and priority rules provide for a pro rata distribution.

(b) To the extent established pursuant to paragraph (a) of this Rule and pursuant to the applicable trading allocation and priority rules, each SBT DPM shall have a right to participate for its own account with the other SBT Traders in transactions in securities allocated to the SBT DPM that occur at the SBT DPM's previously established bid or offer whether the bid or offer was established by a quote or an order. The SBT DPM Committee may determine whether the participation entitlement shall be applicable to the opening transaction.

* * * * *

Allocation of SBT DPMs

Rule 44.16

Different members may be allocated the same class for different trading sessions, that is, an SBT DPM may be allocated a particular option class in one trading session but not another. Also, the appropriate SBT DPM Committee may allocate classes to SBT DPMs on a rotating basis such that the SBT DPM assigned to a particular option class for a particular trading session rotates between two or more SBT DPMs on a periodic basis.

* * * * *

**Chapter XLV**

*Section A: SBT Brokers*

SBT Broker Defined

Rule 45.1

An SBT Broker is an individual (either a member or a nominee of a member organization) who is registered with the Exchange for the purpose of accepting and executing orders received from members, from registered broker-dealers, or from public customers on the SBT System. An SBT Broker shall not accept an order from any source other than a member or a registered broker-dealer unless he is either the nominee of, or has registered his individual membership for, a member organization approved to transact business with the public in accordance with Rule 9.1. In the event the organization is approved pursuant to Rule 9.1, an SBT Broker who is the nominee of, or who has registered his individual membership for such organization, may then accept orders directly from public customers where (i) the organization clears and carries the customer account or (ii) the organization has entered into an agreement with the public customer to execute orders on its behalf. Among the requirements an SBT Broker must meet in order to register pursuant to Rule 9.1 is the successful completion of an examination for the purpose of

demonstrating an adequate knowledge of the securities business.

* * * * *

Registration of SBT Brokers

Rule 45.2

(a) An applicant for registration as an SBT Broker shall file his application in writing with the Membership Department on such form or forms as the Exchange may prescribe. Applications shall be reviewed by the Membership Committee, which shall consider an applicant's ability as demonstrated by his passing an examination prescribed by the Exchange, and such other factors as the Committee deems appropriate. After reviewing the application, the Committee shall either approve or disapprove the applicant's registration as an SBT Broker.

(b) The registration of any person as an SBT Broker may be suspended or terminated by the appropriate Market Performance Committee upon a determination that such person has failed to properly perform as an SBT Broker.

(c) Any member or prospective member adversely affected by a determination of the appropriate Market Performance Committee under this Rule may obtain a review in accordance with the provisions of Chapter XIX.

(d) An SBT Broker must receive authorization, in a manner prescribed by the Exchange, by a clearing member prior to entering orders for a clearing member.

* * * * *

Rule 45.3 to Rule 45.10 Reserved

* * * * *

*Section B: Clearing Firm Broker Functions*

Clearing Firm Broker Functions

Rule 45.11

(a) *Defined.* A Clearing Firm Broker is an individual who represents the Clearing Firm of a particular SBT Market-Maker and has the authority to take certain actions with respect to that SBT Market-Maker's use of the SBT System.

(b) *Forced Logout of Trader.* The Clearing Firm User may request the Help Desk to logout an SBT Market-Maker. Upon the logout of an SBT Market-Maker, the System cancels all the quotes for that SBT Market-Maker. The logout can also be used to cancel all the trader's regular orders and de-authorize the trader as a user. In the event the trader has been de-authorized, the System will not permit an SBT Market-Maker who has been forcibly logged out to log in again until he is re-authorized as an SBT Trader by the Clearing Firm User.

* * * * *

**Chapter XLVI**

*System Operator/Administrator Functions and Data Dissemination Functions*

* * * * *

Quote and Trading Information

Rule 46.1

(a) *Internal Dissemination of Quote.* The SBT System will disseminate the best bid and offer internally. As each new limit order (whether as an order or as part of a market-maker quote) is entered into the SBT System, the best bid and offer displayed in the System is updated to the extent the new bid or offer improves the previously displayed bid or offer. The SBT System will send quote/order information—series, price, size, and order source (Market-Maker, customer, or non-customer professional order)—to the SBT workstations that are trading a given class. The SBT System will also provide the current best bid or offer in any other market, as such best bids or offers are identified in the System.

(b) *Internal Dissemination of Price/Last Sale.* The SBT System may disseminate internally to subscribers that have indicated interest in a given class last sale information including series, price, and size. All SBT Market-Makers assigned to a given class will be provided this information but other individuals and firms may subscribe to this information as well.

(c) *Booked Order Dissemination.* When an SBT Trader or authorized access point requests information for an option class, the SBT System will provide the information which presents the Book's best bids, asks, and their total volumes for each series of the class requested. The Exchange may delete or add categories of disseminated information as it deems appropriate.

(d) *Book Depth.* Upon request, SBT Traders can access from the SBT System market depth information including the aggregate size and the number of contracts at each price. The Exchange may charge fees for access to this information. The information may not be provided upon request if the Exchange believes that it could lead to degradation of the service of the SBT System.

* * * * *

Dissemination of Market Information

Rule 46.2

The SBT System will disseminate quote and trade (last sale) information externally. Series, price and size will be disseminated for trades. Series and price and size will be disseminated for quotes. Every best Book bid or ask change will generate a quote report. The SBT quote width may be wider than the legal width market because two unrelated orders, separated by more than the legal width market, may be the best orders, causing the System to send their prices as the best quote.

* * * * *

Proprietary Information of the Exchange

Rule 46.3

Information sent over the Exchange's SBT System to the SBT Traders and participants is proprietary information of the Exchange and may not be distributed or shared without written permission of the Exchange.

* * * * *

**Chapters XLVII to XLIX [Reserved]**

* * * * *

**Appendix A—Applicability of Rules of the Exchange**

This Appendix lists the rules in Chapters I (1) through XXVII (27) of the rules of the Exchange that apply to the trading of products on the Exchange's screen based trading system. Where a rule in Chapters 1 through 27 is supplemented by a rule in Chapters 40 through 49, that fact is so indicated.

| Existing rule | Supplemented by |
|---|---|
| **Chapter I—Definitions** | |
| 1.1 Definitions | 40.1 |

| Existing rule | Supplemented by |
|---|---|
| **Chapter II—Organization and Administration** | |
| **Part A: Committees** | |
| 2.1 Committees of the Exchange | |
| **Part B: Departments** | |
| 2.15 Departments of Exchange | |
| **Part C: Dues, Fees and Other Charges** | |
| 2.20 Membership Dues | |
| 2.21 Charge on Net Commissions | |
| 2.22 Other Fees or Charges | |
| 2.23 Liability for Payment | |
| 2.24 Exchange's cost of defending legal proceedings | |
| **Chapter III—Membership** | |
| 3.1 Public Securities Business | |
| 3.2 Qualifications and Membership Statuses of Individual Members | |
| 3.3 Qualifications and Membership Statuses of Member Organizations | |
| 3.4 Qualifications of Foreign Member Organizations | |
| 3.5 Denial of and Conditions to Membership and Associations | |
| 3.6 Persons Associated With Member Organizations | |
| 3.6A Qualifications and Registration of Certain Associated Persons | |
| 3.7 Certain Documents Required of Members, Applicants and Associated Persons | |
| 3.8 Nominees and Members Who Register Their Memberships for Member Organizations | |
| 3.9 Application Procedures and Approval or Disapproval | 41.1 |
| 3.10 Effectiveness of Membership or Approved Associated Person Status | |
| 3.11 Notice of Effectiveness of Membership or Approved Associated Person Status | |
| 3.12 Membership Rights and Restrictions on Their Transfer | |
| 3.13 Purchase of Membership | |
| 3.14 Sale and Transfer of Membership | |
| 3.15 Proceeds from Sale of Membership | |
| 3.16 Special Provisions Regarding Chicago Board of Trade Exerciser Memberships | |
| 3.17 Leased Memberships | |
| 3.18 Members and Associated Persons Who Are or Become Subject to a Statutory Disqualification | |
| 3.19 Termination from Membership | |
| 3.20 Dissolution and Liquidation of Member Organizations | |
| 3.21 Obligations of Terminating Members | |
| 3.22 [Reserved] | |
| 3.23 Integrated Billing System | |
| 3.24 Member Death Benefit | |
| 3.25 Transfer of Individual Membership in Trust | |
| 3.26 IPC Permits | |
| 3.27 Options Trading Permits | |
| 3.28 Extension of Time Limits | |
| 3.29 Delegation of Authority | |
| **Chapter IV—Business Conduct** | |
| 4.1 Just and Equitable Principles of Trade | |
| 4.2 Adherence to Law | |
| 4.3 Sharing of Offices and Wire Connections | |
| 4.4 Gratuities | |
| 4.5 Nominal Employment | |
| 4.6 False Statements | |
| 4.7 Manipulation | |
| 4.8 Rumors | |
| 4.9 Disciplinary Action by Other Organizations | |
| 4.10 Other Restrictions on Members | |
| 4.11 Position limits | |
| 4.12 Exercise limits | |
| 4.13 Reports related to position limits | |
| 4.14 Liquidation of positions | |
| 4.15 Limit on outstanding uncovered short position | |
| 4.16 Other restrictions on options transactions and exercises | |
| 4.18 Prevention of misuse of material, nonpublic information | |
| **Chapter V—Securities Dealt In** | |
| 5.1 Designation of securities | |
| 5.2 Rights and obligations of holders and writers | |
| 5.3 Criteria for underlying securities | |
| 5.4 Withdrawal of approval of underlying securities | |

| Existing rule | Supplemented by |
|---|---|
| 5.5 Series of option contracts open for trading | |
| 5.7 Adjustments | |
| 5.8 Long-Term Equity Option Series (LEAPS™) | |
| **Chapter VI—Doing Business on the Exchange Floor** | |
| **Section A: General** | |
| 6.1 Days and Hours of Business | 42.1 |
| 6.3 Trading Halts | 43.4 |
| 6.3B Trading Halts Due to Extraordinary Market Volatility | 43.4 |
| 6.5 Limitation on Dealings. | |
| 6.6 Unusual Market Conditions | 43.4 |
| 6.7 Use of Facilities of Exchange | |
| 6.7A Legal proceedings against Exchange directors, officers, employees or agents | |
| **Section B: Member Activities on the Floor** | |
| 6.20 Admission to and Conduct on the Trading Floor | |
| **Section C: Trading Practices and Procedures** | |
| 6.40 Unit of trading | |
| 6.41 Meaning of premium bids and offers | |
| 6.43 Manner of bidding and offering | |
| 6.49 Transactions off the Exchange | |
| 6.50 Submission for Clearance | |
| 6.52 Price Binding Despite Erroneous Report | |
| 6.53 Certain Types or Orders Defined | 43.3 |
| 6.58 Submission of trade information to the Exchange | |
| 6.64 Maintaining Office and Filing Signatures | |
| 6.65 Written Contracts | |
| 6.66 Comparison Does Not Create Contract | |
| **Section D: Floor Brokers** | |
| 6.72 Letters of Authorization | |
| 6.73 Responsibilities of Floor Brokers | |
| 6.76 Payment for Floor Brokerage Services | |
| 6.75 Discretionary transactions | |
| **Chapter VIII—Market-Makers, Trading Crowds and Modified Trading Systems** | |
| **Section A: Market-Makers** | |
| 8.5 Letters of Guarantee | |
| 8.8 Restriction on Acting as Market-Maker and Floor Broker | |
| 8.9 Securities Accounts and Orders of Maker-Makers | |
| 8.10 Financial Arrangements of Market-Makers | |
| 8.11 Transactions for Public Customers | |
| **Section B: Evaluation of Trading Crowd Performance** | |
| 8.51 Trading Crowd Firm Disseminated Market Quotes | |
| 8.60 Evaluation of Trading Crowd Performance | |
| **Section C: Modified Trading System** | |
| 8.86 DPM Financial Requirements | |
| 8.88(a) and (b) Review of DPM Operation and Performance | |
| 8.89 Transfer of DPM Appointments | |
| 8.91 Limitations on Dealings of DPMs and Affiliated Persons of DPMs | |
| **Section D: Allocation of Securities and Location of Trading Crowds and DPMs** | |
| 8.95 Allocation of Securities and Location of Trading Crowds and DPMs | 44.16 |
| **Chapter IX—Doing Business With the Public** | |
| 9.1 Exchange approval | |
| 9.2 Registration of Options Principals | |
| 9.3 Registration and Termination of Representatives | |
| 9.4 Other Affiliations of Registered Representatives | |
| 9.5 Discipline, Suspension, Expulsion of Registered Persons | |
| 9.6 Branch Offices of Member Organizations | |
| 9.7 Opening of Accounts | |
| 9.8 Supervision of Accounts | |

| Existing rule | Supplemented by |
|---|---|
| 9.9 Suitability Recommendations<br>9.10 Discretionary Accounts<br>9.11 Confirmation to Customers<br>9.12 Statements of Accounts to Customers<br>9.13 Statements of Financial Condition to Customers<br>9.14 Addressing of Communications to Customers<br>9.15 Delivery of current options disclosure documents and prospectus<br>9.16 Restrictions on Pledge and Lending of Customers' Securities<br>9.17 Transactions of Certain Customers<br>9.18 Guarantees and Profit Sharing<br>9.19 Assuming Losses<br>9.20 Transfer of Accounts<br>9.21 Communications to Customers<br>9.22 Brokers' Blanket Bonds<br>9.23 Customer Complaints<br>9.24 Telephone solicitation | |
| **Chapter X—Closing Transactions**<br>**Part A: Options Contracts** | |
| 10.2 Contracts of suspended members<br>10.3 Failure to pay premium | |
| **Chapter XI—Exercises and Deliveries** | |
| 11.1 Exercise of option contracts<br>11.2 Allocation of exercise notices<br>11.3 Delivery and payment | |
| **Chapter XII—Margins** | |
| 12.1 General Rule<br>12.2 Time Margin Must Be Obtained<br>12.3 Margin Requirements<br>12.5 Determination of Value for Margin Purposes<br>12.7 ''When Issued'' and ''When Distributed'' Securities<br>12.8 Guaranteed Accounts<br>12.9 Meeting margin Calls by Liquidation Prohibited<br>12.10 Margin Required Is Minimum<br>12.11 Compliance with Margin Requirements of New York Stock Exchange<br>12.12 Daily Margin Record | |
| **Chapter XIII—Net Capital Requirements** | |
| 13.1 Minimum Requirements<br>13.2 ''Early Warning'' Notification Requirements<br>13.3 Power of President to Impose Restrictions | |
| **Chapter XIV—Commissions** | |
| 14.2 Reciprocal Arrangements<br>14.3 Commissions on Non-Member Orders<br>14.5 Intra-Member Rates for Floor Brokers | |
| **Chapter XV—Records, Reports and Audits** | |
| 15.1 Maintenance, Retention and Furnishing of Books, Records and Other Information<br>15.2 Reports of Transactions<br>15.3 Reports of Uncovered Short Positions<br>15.4 Monthly Commission Report<br>15.5 Financial Reports<br>15.6 Audits<br>15.7 Automated Submission of Trading Data<br>15.8 Risk Analysis of Market-Maker Accounts<br>15.9 Regulatory Cooperation<br>15.10 Reporting requirements applicable to short sales in Nasdaq National Market | |
| **Chapter XVI—Summary Suspension by Chairman of the Board or Chairman of the Executive Committee** | |
| 16.1 Imposition of Suspension<br>16.2 Investigation Following Suspension<br>16.3 Reinstatement<br>16.4 Failure to Obtain Reinstatement<br>16.5 Termination of Rights by Suspension | |

| Existing rule | Supplemented by |
|---|---|
| **Chapter XVII—Discipline** | |
| 17.1 Disciplinary Jurisdiction<br>17.2 Complaint and Investigation<br>17.3 Expedited Proceeding<br>17.4 Charges<br>17.5 Answer<br>17.6 Hearing<br>17.7 Summary Proceedings<br>17.8 Offers of Settlement<br>17.9 Decision<br>17.10 Review<br>17.11 Judgment and Sanction<br>17.12 Miscellaneous Provisions<br>17.13 Extension of time limits<br>17.14 Reporting to the Central Registration Depository<br>17.50 Imposition of fines for minor rule violations | |
| **Chapter XVIII—Arbitration** | |
| 18.1 Matters Subject to Arbitration<br>18.2 Procedure in Member Controversies | |
| **Uniform Arbitration Code** | |
| 18.3 Arbitration<br>18.3A Class action arbitration<br>18.4 Simplified Arbitration<br>18.5 Waiver of Hearing<br>18.6 Time Limitation Upon Submission<br>18.7 Dismissal or Termination of Proceedings<br>18.8 Settlements<br>18.9 Tolling of Time Limitation(s) for the Institution of Legal Proceedings and Extension of Time Limitation(s) for Submission to Arbitration.<br>18.10 Designation of Number of Arbitrators<br>18.11 Notice of Selection of Arbitrators<br>18.12 Peremptory Challenges<br>18.13 Disclosures Required or Arbitrators<br>18.14 Disqualification or Other Disability of Arbitrators<br>18.15 Initiation of Proceedings<br>18.16 Designation of Time and Place of Hearings<br>18.17 Representation by Counsel<br>18.18 Attendance at Hearings<br>18.19 Failure to Appear<br>18.20 Adjournments<br>18.21 Acknowledgment of Pleadings<br>18.24 Evidence<br>18.25 Interpretation of the Code and enforcement of arbitrator ruling<br>18.26 Determination of Arbitrators<br>18.27 Record of Proceedings<br>18.28 Oaths of the Arbitrators and Witnesses<br>18.29 Amendments<br>18.30 Reopening of Hearings<br>18.31 Awards<br>18.32 Miscellaneous<br>18.33 Schedule of Fees<br>18.35 Requirements when Using Pre-Dispute Arbitration Agreements with Customers<br>18.37 Failure to honor award | |
| **Chapter XIX—Hearings and Review** | |
| 19.1 Scope of Chapter<br>19.2 Submission of Application to Exchange<br>19.3 Procedure Following Applications for Hearing<br>19.4 Hearing<br>19.5 Review<br>19.6 Miscellaneous Provisions | |
| **Part B: Verification Procedures** | |
| 19.50 Scope of Part B<br>19.51 Definitions<br>19.52 Requests for verification | |

| Existing rule | Supplemented by |
|---|---|
| **Chapter XXI—Government Securities Options** | |
| 21.1 Definitions | |
| 21.2 Wire Connections | |
| 21.3 Position limits (Treasury bonds and notes) | |
| 21.4 Exercise limits (Treasury bonds and notes) | |
| 21.5 Reports related to position limits and liquidation of positions (Treasury bonds and notes) | |
| 21.6 Designation of government security options (Treasury bonds and notes) | |
| 21.7 Approval of underlying Treasury securities for specific coupon options (Treasury bonds and notes) | |
| 21.8 Terms of Treasury security options (Treasury bonds and notes) | |
| 21.9 Series of Treasury security options open for trading (Treasury bonds and notes) | |
| 21.10 Days and hours of business | |
| 21.12 Trading halts and suspension of trading | |
| 21.13 Meaning of premium bids and offers (Treasury bonds and notes) | |
| 21.16 Reconciliation of unmatched trades | |
| 21.17 Responsibilities of floor brokers | |
| 21.18 Post coordinators for government securities options | |
| 21.19 Obligations of market-makers (Treasury bonds and notes) | |
| 21.19A Doing business with the public | |
| 21.23 Allocation of exercise assignment notices | |
| 21.24 Delivery and payment (Treasury bonds and notes) | |
| 21.25 Margin requirements | |
| 21.30 Furnishing of Books, records and other information | |
| 21.31 Special rules for Treasury bill options | |
| **Chapter XXIII—Interest Rate Option Contracts** | |
| 23.1 Definitions | |
| 23.2 Wire connections | |
| 23.3 Position limits | |
| 23.4 Exercise limits | |
| 23.5 Terms of interest rate option contract | |
| 23.6 Days and hours of business | |
| 23.8 Trading halts and suspension of trading | |
| 23.9 Meaning of premium—bids and offers | |
| 23.10 Accommodation liquidations | |
| 23.11 Reconciliation of unmatched trades | |
| 23.12 Responsibilities of floor brokers | |
| 23.13 Margin requirements | |
| 23.14 Limitation of liability | |
| 23.15 Furnishing of books, records and other information | |
| **Chapter XXIV—Index Options** | |
| 24.1 Definitions | |
| 24.2 Designation of the index | |
| 24.3 Dissemination of information | |
| 24.4 Position limits for broad-based index options | |
| 24.4A Position limits for industry index options | |
| 24.5 Exercise limits | |
| 24.6 Days and hours of business | |
| 24.7 Trading halts or suspensions | |
| 24.8 Meaning of premium bids and offers | |
| 24.9 Terms of index option contracts | |
| 24.10 Restrictions on contracts | |
| 24.11 Margins | |
| 24.11A Debit put spread cash account transactions | |
| 24.13 Trading rotations | |
| 24.14 Disclaimers | |
| 24.18 Exercise of American-style index options | |
| **Chapter XXVI—Market Baskets** | |
| 26.1 Definitions | |
| 26.2 Terms of market basket contracts | |
| 26.3 Meaning of bids and offers | |
| 26.4 Dissemination of information | |
| 26.5 Opening of trading | |
| 26.6 Position limits | |
| 26.7 Exercise limits | |
| 26.8 Delivery and payment | |
| 26.9 Margins | |
| 26.10 Doing business with the public | |
| 26.11 Market-makers | |

| Existing rule | Supplemented by |
|---|---|
| 26.12 DPM financial requirements<br>26.13 Floor broker financial requirements<br>26.14 Exchange authorization required | |
| **Chapter XXVII—Buy-Write Option Unitary Derivatives (''BOUNDs'')** | |
| 27.1 Definitions<br>27.2 Rights and obligations of holders and sellers<br>27.3 BOUND contracts to be traded<br>27.4 Restrictions on transactions in BOUNDs<br>27.5 BOUND expiration schedule, series of BOUNDs open for trading, strike prices<br>27.6 Application of certain Rules to BOUNDs<br>27.7 Position limits<br>27.8 Reporting of BOUNDs positions and related Rules<br>27.9 Delivery and payment<br>27.10 Margin | |

* * * * *

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

*A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

1. Purpose

The proposed rule change sets forth rules governing the Exchange's screen-based trading (''SBT'') system (''SBT System'' or ''System''), known as CBOE*direct.* CBOE*direct* will supplement the Exchange's floor-based open outcry auction market. Although it has been designed to be able to trade options during the regular trading hours or during extended trading hours, CBOE*direct* initially will be used to trade only during hours when the open outcry auction market is not open.[4]

CBOE's existing rules would govern trading on the SBT System, except as those rules are superseded or supplemented by the rules in Chapters XL through XLIX. CBOE is presently proposing to adopt SBT rules in Chapters XL through XLVI and would reserve Chapters XLVII through XLIX for future SBT rules, if it became necessary to adopt additional rules.

a. Basics of the SBT System

Unlike with the open outcry auction market, execution priority of orders in CBOE*direct* would not necessarily depend on originator type (*e.g.,* market maker, customer, firm, or broker-dealer). As discussed further below, orders would be executed on the System using either a strict price/time priority or a price/time pro rata allocation procedure. However, the Exchange's SBT Trading Committee would have the authority to overlay customer priority on either of these two allocation procedures. In addition, the SBT Trading Committee would have authority to allocate a trade participation right to an SBT Designated Primary Market Maker (''SBT DPM'') or an SBT Lead Market Maker (''SBT LMM'').[5] The initial SBT DPM/LMM participation entitlement percentage would be 30%, which CBOE would indicate in a circular distributed to the Exchange's membership. It is possible that the SBT Trading Committee might provide for different priority methods for different option classes at the same time. By doing so, the SBT Trading Committee could tailor the particular priority method to the particular option class (since the trading in different classes can vary), meet changes in priority structures put in place at competing exchanges, and experiment to determine which priority methods attract the most customer demand. CBOE has represented that, in any event, it would publicize the type of priority structure that applied to each particular option class so that all market participants were able to know what would be the relative priority of their orders for any particular option class.

As currently designed, CBOE*direct* would disclose neither the source of an order nor the contra-parties to a trade, except as identities of the trade participants might be revealed in connection with trade nullification procedures set forth in the proposed rules.

A number of SBT Standard Market Makers would be assigned to each class traded on CBOE*direct.* An SBT DPM also might be assigned to a class traded on the System and, if one were so assigned, would be obligated to provide opening quotes for all the series in its assigned classes. If no SBT DPM had been assigned to a particular trading class, the SBT Standard Market Makers would be obligated to provide opening quotes.[6] In addition, SBT Market Makers (either SBT Standard Market Makers, SBT DPMs, or SBT LMMs) assigned to a class would be obligated to respond to a certain minimum percentage of request for quotes (''RFQs'') in their assigned classes.[7] If

[4] On September 7, 2001, CBOE submitted to the Commission a Form PILOT with respect to CBOE*direct,* pursuant to Rule 19b–5 under the Act, 17 CFR 240.19b–5. A self-regulatory organization may commence operation of a pilot trading system 20 days after filing a Form PILOT. *See* 17 CFR 240.19b–5(e)(1). CBOE commenced operation of a SBT System on October 26, 2001. Rule 19b–5 requires a self-regulatory organization, within two years of commencing operations of the pilot trading system, to file a proposed rule change—pursuant to Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2)—to obtain permanent authority to operate that system. *See* 17 CFR 240.19b–5(f)(1). The present filing (SR–CBOE–00–55) was submitted pursuant to the requirement.

[5] Although the maximum guaranteed percentage entitlement for an SBT DPM/LMM would be 40%, the participation of an SBT DPM/LMM on any particular trade may be greater if the applicable allocation and priority rules so provide.

[6] The appropriate Market Performance Committee also might appoint an SBT LMM on a rotating basis which, like an SBT DPM, would have an obligation to provide opening quotes and to respond to RFQs at a higher rate than standard SBT Market Makers. Also an SBT LMM, like an SBT DPM, might have a guaranteed participation right for trades executed at its previously established quote. Initially, the guaranteed participation rate for SBT LMMs would be 30%. CBOE has stated that it would issue a circular to its membership indicating this participation rate. SBT LMMs also might have a continuous quoting obligation.

[7] Under the present open outcry system, a market maker is obligated, among other things, to compete with other market to improve markets in all series of option classes at the station where the market

CBOE*direct* were used during extended trading hours when there was little liquidity in the underlying market, the appropriate Market Performance Committee or two Trading Officials could exempt the market makers from providing opening quotes or responding to RFQs. SBT Standard Market Makers, SBT DPMs, and SBT LMMs would have other obligations as further described below and in the proposed rules.

Only SBT Market Makers (including SBT DPMs/LMMs) could enter quotes. Order providers (SBT Brokers and Proprietary Traders) would be prohibited from entering limit orders in the same options series, for the accounts or accounts of the same or related beneficial owners, in such a manner that the order provider or the beneficial owner(s) effectively would be operating as a market maker by holding itself out as willing to buy and sell option contracts on a regular or continuous basis. Market maker quotes would be entered as two simultaneous orders (a buy order and a sell order) with any width. For a quote to count towards an SBT Market Maker's quote obligations (*i.e.,* the RFQ response requirement or continuous quote requirement), a quote would have to be no wider than a prescribed width and for an amount equal to or greater than some prescribed size. All market participants, including SBT Market Makers, could submit regular orders, for any class.

CBOE*direct* would accept market maker, firm, and broker-dealer orders in addition to public customer orders.

maker is present; to make markers which, absent changed market conditions, will be honored to a reasonable number of contracts in all series of option classes at the station where the market maker is present; and to update quotations in response to changed market conditions in all series of option classes at the station where the market maker is present. As a practical, however, quotes in all of the thousands of series trades at one station are provided by an autoquote system, while the market makers will verbally update and improve a number of the series on a periodic basis. It is possible for a market maker in the open outcry system, however, to avoid actively updating quotes, although CBOE does have a number of means to monitor for compliance. It would not be possible for an SBT Market Maker to avoid its obligations, as the System would monitor compliance and keep track of every response an SBT Market Maker had submitted.

CBOE anticipates that a number of SBT Market Makers would choose to provide continuous quotes, although the Exchange would not require them to do so. CBOE believes, however, that the quotes stream that would be produced if all market makers were required to provide continuous quotes for such a large number of series as might be listed on the System would overwhelm the quote dissemination systems currently in place at the Options Price Reporting Authority (''OPRA'') and a third-party quote vendors. CBOE doubts whether there would be any benefit from imposing such a requirement.

Spread orders and certain contingency orders also would be accepted.

Customer, firm, and broker-dealer orders could be submitted through an SBT workstation, the current wire order facility (used to send orders to the Exchange's open outcry auction market), or through a computer-to-computer link using CBOE's new application program interface (''API''). CBOE has stated that it might limit the number of market makers that could access CBOE*direct* through an API in order to protect the integrity of the System. In addition, CBOE has stated that it might impose restrictions on the use of a computer connected through an API if it believed such restrictions were necessary to ensure the proper performance of the System. CBOE has represented that these limitations would be only for the purpose of protecting the integrity of the System and would not be used in a discriminatory or arbitrary fashion.

Market maker orders and quotes could be submitted through an SBT workstation or the API.

Book depth and other market information would be available to all participants, although fees might be charged for access to certain of the information. CBOE has represented that these fees would be charged in a non-discriminatory manner and set at a level to ensure that the performance of the System did not become degraded.

Both opening and closing procedures would be handled automatically. SBT Market Makers assigned to a class would participate in the opening trade on an individual basis by providing their own quotes. SBT DPMs would be obligated to provide their opening quotes. The System would determine automatically the opening price that would clear the market and trade the maximum quantity at the open.[8] Spread orders and contingency orders (except for ''opening only'' orders) would not participate in the opening trade or in the determination of the opening price.[9] CBOE believes that the exclusion of these order types from the opening process would not only simplify the process for completing the opening, but also be consistent with the operation of the System which treats spread orders separately from other orders. Market participants wishing to have their spread orders represented in the opening could separate the order into distinct legs which could be represented in the opening. Likewise, market participants wishing to trade a contingency order could choose not to impose the contingency until after the opening if they wanted to attempt to participate in the opening.

In CBOE*direct,* the series of a class would not have to open all at the same time. Those that could open would be opened and those that could not open because of some reason (*e.g.,* market order imbalance) would cycle through the pre-opening and opening rotation procedures until they could open.

Unlike with the open outcry system, a CBOE autoquote facility would not be available to SBT Market Makers. However, CBOE anticipates that SBT Market Makers might use their proprietary autoquote systems to submit quotes through the API.

SBT Traders could trade from their offices or from any location where they had a workstation and communication link to the Exchange. An SBT Trader would have to be assigned a membership in order to trade on the System. However, current membership rules, which are applicable to the SBT System, provide for a different trader to use the regular trader's seat in certain situations. SBT Traders could avail themselves of current CBOE Rule 3.8, which allows a nominee of a firm to transfer onto a seat that is generally used by another nominee of the same firm. A firm would thereby be permitted to allow one nominee to trade on the seat during regular trading hours and a different nominee to trade on the seat during a CBOE*direct* extended trading hour session.

Other users of the System—besides SBT Market Makers and SBT Brokers—would include Proprietary Traders, Clearing Firm Users, and SBT System Operators/Administrators. Proprietary Traders would be members who entered orders as principal for non-market-maker proprietary accounts. Clearing Firm Users would be members who monitored and regulated the activities of SBT Traders trading through the clearing firm of the Clearing Firm User. SBT System Operators/Administrators would be Exchange employees who supported the operation of the System.

*Extended Trading Hour Session*

Initially, CBOE*direct* is intended to be used to trade options only during one or more extended trading hour (''ETH'') sessions and not during the regular trading hour (''RTH'') session during which options are currently traded on the Exchange. At this time, CBOE

[8] Today in the open outcry system, CBOE employs a Rapid Opening System (''ROS'') to open some classes in a quick and automated fashion.

[9] The Commission notes that proposed CBOE Rule 42.3, *Opening and Closing Rotation Procedures,* is not consistent with its position in order approving CBOE's Rapid Opening System (''ROS'') pilot program that non-bookable orders should be incorporated into ROS. *See* Securities Exchange Act Release No. 41033 (February 9, 1999), 64 FR 8156 (February 18, 1999).

intends to trade a number of index option products during a morning session from 7 a.m. to 8:15 a.m. Central Time, before the normal opening for the open outcry auction market at 8:30 a.m. CBOE has not finalized the products that will be traded on the System, but as of April 24, 2002, the only products trading on CBOE*direct* were all series (except LEAPS) of options on the Standard & Poor's 100 index (''OEX''), the Russell 2000 (''RUT''), and the Dow Jones Industrial Average (''DJX'').[10] Of course, the trading hours during which the System is used and the products traded on the System could change at any time based upon the competitive landscape, the interests of the Exchange's membership, and customer demand. At this time, CBOE intends to provide OPRA reports of quote and last sale during the ETH session(s) different from those sent during the RTH session so that the reports could be easily distinguished. The trading symbols for the classes would, however, be identical during the RTH and ETH sessions, and the contracts traded in both sessions would be fungible.

Initially, the System would not provide for the passing of orders between the ETH session and the RTH session. ''Time in force'' indicators would be used on orders routed to the Exchange to indicate whether the order was to be represented in the ETH session or the RTH session. Eventually, the System would allow for a variety of ''time in force'' codes that would provide for the order to be represented in more than one or all of the sessions of a current trading day. As a protection to customers and firms, CBOE would limit the time frames during which order types could be submitted to the Exchange, such that any order submitted would have to be designated for the current or next trading session of the current trading day.

Initially, during the ETH period, CBOE expects to require SBT DPMs/LMMs to continuously quote all series in the front two months and all series that are no more than 5% in-the-money or out-of-the-money. For those series that would not be continuously quoted, CBOE expects to impose an 85% RFQ response rate on SBT DPMs/LMMs and a 10% RFQ response rate on standard SBT Market Makers. The RFQ response rate would be calculated over a monthly period.

[10] Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Nancy Sanow, Division, Commission, on April 24, 2001.

*Definitions and Application of Other Rules*

The Exchange has proposed a definitional rule, CBOE Rule 40.1, to define those terms that are unique to the SBT System.

- ''Screen Based Trading System'' or ''SBT System'' would be defined as the electronic system administered by the Exchange that would perform the functions set out in Exchange rules including controlling, monitoring, and recording trading by members through SBT workstations and trading between members.
- ''Application Program Interface'' or ''API'' would mean the computer program that would allow SBT Traders on their own computers or on CBOE- or vendor-supplied workstations to interface with the SBT System.
- ''SBT Book'' would mean all unexecuted orders, other than spread orders, currently held by the SBT System.
- ''SBT Spread Book'' would mean all unexecuted spread orders currently held by the SBT System.
- ''SBT workstation'' would mean a computer workstation connected to the SBT System for the purposes of trading pursuant to the rules in proposed Chapters XL through XLIX.
- ''Trading Official'' would mean an Exchange employee or member who is granted certain duties under these rules to take actions affecting either the operation of the SBT System or the responsibilities of SBT Traders.[11]
- ''SBT Trader'' would mean an individual or organization that had the right to trade on the SBT System.
- ''Market Turner'' would mean an SBT Trader who was the first SBT Trader to enter an order (quote) at a better price than the previous best book price prior to the trading of an order, and the order (quote) was continuously in the market until the particular order traded.
- ''Legal Width Market'' would mean a bid and offer that was at or within the prescribed width as set forth in proposed CBOE Rule 44.4. For most purposes under these rules, a legal width market could be established by a bid from one SBT Trader and an offer from a different SBT Trader.

The Exchange also has proposed CBOE Rule 40.2, which would specify that, to the extent that existing Chapters I through XXVII of the CBOE rules are applicable to trading on the SBT System (as indicated by the context or by Appendix A to the SBT rules), the terms used in Chapters I through XXVII should be read to have the following meanings where appropriate:

- ''Floor'' should be read to mean SBT System;
- ''Floor Official'' should be read to mean Trading Official;
- ''Appropriate Floor Procedure Committee'' should be read to mean ''appropriate SBT Trading Committee;''
- ''Floor Broker'' should be read to mean ''SBT Broker'' where appropriate;
- ''Market-Maker'' should be read to mean ''SBT Standard Market-Maker,'' ''SBT LMM,'' or ''SBT DPM,'' as appropriate; and
- References in rules to ''the Exchange'' should be read to include the SBT System, where appropriate.

Any Exchange member who chose to participate on the SBT System could register with the Membership Committee as an SBT Market Maker (who could then act as an SBT Standard Market Maker, SBT LMM, or SBT DPM), SBT Broker, or Proprietary Trader. The Membership Committee would be responsible for approving applications of Exchange members as an SBT Market Maker, SBT Broker, or Proprietary Trader for the SBT System.

Once the SBT System had been enabled to recognize Replacement Traders, individual SBT Market Makers could nominate a Replacement Trader who would have to be qualified and registered with the Exchange as such. The Membership Committee would be responsible for qualifying and approving Replacement Traders. Replacement Traders for a nominee of a member firm would have to be nominees of the same firm or have their memberships registered for the same firm. When an SBT Market Maker logged off the SBT System, it could first choose to transfer its position to a Replacement Trader. Any quote transferred in that manner would retain its priority.

*Access*

For purposes of the SBT System that would be used during an ETH session, a member could use its membership to trade during the ETH session. As mentioned previously, a member organization also could have a different nominee use its membership to trade on the SBT System, pursuant to existing CBOE Rule 3.8.

*Types of SBT System Users*

As mentioned above, there would be a number of types of users of SBT workstations: SBT Market Makers

[11] The Commission notes that there are several instances in the proposed rules where ''two Trading Officials'' or ''Trading Officials'' or ''Exchange Officials'' would be able to take various actions. The Commission believes that, in certain proposed rules, the discretion afforded to ''Trading Officials'' or ''Exchange Officials'' may be overbroad.

(including Standard SBT Market Makers, SBT LMMs, and SBT DPMs); Proprietary Traders; Clearing Firm Users; and SBT System Operators/Administrators.

Market makers would operate the SBT workstation for the following functions:

- Enter, cancel, cancel/replace, and maintain two-sided quotes;
- Enter, cancel, cancel/replace, and maintain orders;
- Hit bids and take offers;
- Submit RFQs;
- Respond to RFQs;
- Communicate with contra-parties for nullifying trades; and
- Set up defaults or preferences.

SBT Brokers and Proprietary Traders would operate the SBT workstations for the following functions:

- Enter, cancel, cancel/replace, and maintain orders;
- Hit bids and take offers;
- Submit RFQs;
- Enter cross-notification and cross-execution orders;
- Communicate with contra-parties for nullifying trades; and
- Set up defaults or preferences.

Orders from SBT Brokers and Proprietary Traders could be entered through the Exchange's existing member firm front-end system. CBOE estimates that, initially, 80% of retail orders for SBT products would continue to be submitted as wire orders via ORS. The remaining 20%—composed of contingency orders, spread orders, and orders that would have to be ''worked''—are currently transmitted to the floor by phone. For SBT products, this 20% would be submitted via the SBT workstations or through the API.

Clearing Firm Users would regulate the activities of SBT Market Makers that cleared through them. They would use the SBT workstation for the following functions:

- Set the volume limit of market maker orders, by class; and
- Force the logout of a market maker.

SBT System Operators/Administrators would operate workstations located at the Exchange or elsewhere for the following support functions:

- Start/stop the SBT System;
- Start/stop trading by class, by underlying security, or for the entire market;
- Add/change/delete trader IDs to the System;
- Add/change/delete products;
- Change market status such as open, closed, fast market, halt, *etc.* by class, by underlying security, or for the entire market;
- Determine the operating status of any workstation in the network;
- Send automated broadcasts of canned administrative messages to e-mail, fax, voice recording, trading groups, CBOE webpage, and SBT blackboard;
- Send text message to a trader or group of traders;
- Maintain class groups and market maker assignments to classes;
- Maintain market maker profiles which will identify the accounts where trades will settle;
- Maintain relationships between brokers and their executing firms/give-up firms;
- Monitor the log-in status of traders by class;
- Display operating status of various SBT System services;
- Display by class assigned and logged-in market makers;
- Display un-responded RFQs, including source of the RFQ;
- Display a trader's preferences;
- Enter, update, and display a market maker's appointments;
- Display a given terminal's activity for troubleshooting;
- Display trade log by trader ID of today's trades;
- Exercise full SBT workstation functionality by using a test product;
- Display a screen from a particular trader's point of view;
- Bust a trade;
- Force the logout of a market maker in response to a request from a clearing firm;
- Change Exchange-wide trading parameters; and
- Any other function provided for by the Exchange.

b. States of Operation

During the day, a particular class may be in one of the following states of operation: Pre-opening, Opening, Trading, Halted, and Closed.

*Pre-opening.* At this state, the System would accept quotes and orders, except time contingency and crossing orders, but no trading would take place. The System would provide market data, including data on any resting orders from the previous day and orders submitted before the opening, which could be viewed by any SBT Trader who subscribed to the data for that particular class.

*Opening.* The opening would be conducted using a ''maximum contract volume traded'' procedure. Under this procedure, when the primary market disseminated the underlying security's opening trade or opening bid and ask, the class would go into a second Pre-opening phase.[12] The System would send out an Opening Notice (*i.e.,* an RFQ) to SBT Market Makers that were assigned to that class to solicit their opening quotes.

The System would continue to accept quotes and orders, except time contingency and crossing orders, during this state. At the end of this Pre-opening time period, the System would go into an Opening where it would establish an opening price for each series, complete the opening trade, if any, and then change the state of the class to Trading.

*Trading.* During this state, the series would trade freely. All order types and quotes would be accepted during the Trading state, except for Opening-only contingency orders.

*Halted.* A particular class or all of the classes traded on CBOE*direct* could be placed in a Halted state for various reasons. The most common reason would be that the primary exchange had halted trading of the underlying security, or no underlying security prices or quotes were being received by the System. The System would send status alerts to OPRA for a product that had been halted. A product would have to go through the Pre-opening and Opening rotation procedures before it reverted to Trading after being Halted. When the System is operated during an ETH session, there might not be a primary market trading the underlying security. In such cases, the System might or might not automatically declare a trading halt if the underlying security had been halted on one or more of the markets trading the underlying security. The appropriate SBT Trading Committee would determine in advance from time to time whether to have the System automatically halt trading on the options if trading in the underlying had been halted in a market trading the underlying during an ETH session.

*Closed.* The System would change the state to Closed at a pre-determined time. Trading would be stopped but the System would continue to accept certain order types to allow traders to maintain their orders. At some designated time, the System would stop accepting orders and would enter into end-of-session procedures such as the purging of expiring orders (*e.g.,* day orders, if the System was used during the traditional trading hours), and reporting of Nothing Done order status to member firms.

*Extended Trading Hours*

During extended trading hours (*i.e.,* that period of time outside of the normal

[12] CBOE anticipates that, with index options trading during the ETH sessions, the Exchange's Help Desk would declare that the particular class was open at some point after the opening time since there would not be an underlying security price disseminated.

trading hours, when CBOE*direct* would be used to trade options), the same states of operation would be employed. Initially, the System would accept only limit orders during the ETH period and would not accept market orders or certain contingency orders. The obligations of SBT DPMs/LMMs and Standard SBT Market Makers might be reduced during the ETH period because of the possibility that liquidity in the underlying securities might be severely reduced during this period of time.

*Unusual Market Conditions*

CBOE*direct* would be capable of declaring both fast markets and trading halts upon the occurrence of certain events, as detailed in proposed CBOE Rule 43.4. Additionally, proposed CBOE Rule 43.4 would supplement the current unusual market condition rule, CBOE Rule 6.6.[13] Proposed CBOE Rule 43.4 would describe the reasons why a Trading Official may determine to declare either a fast market or a trading halt. As with existing CBOE Rule 6.6, once a fast market has been declared, Trading Officials could take such actions as they deemed necessary to maintain a fair and orderly market. Upon the declaration of a fast market, Trading Officials could widen permissible bid/ask spreads by which a market maker must quote in order to receive credit for meeting its quote obligations and the suspend the firm quote obligations pursuant to existing CBOE Rule 8.51.

c. Trade Allocation

Orders would be filled in CBOE*direct* according to the market order processing and limit order processing rules described below. The appropriate SBT Trading Committee would have the authority to apply one of various types of trade allocation methodologies. The System would send fill reports for executed orders to the SBT workstations for display to the traders or to ORS for sending fill reports for wire orders. Executed orders would be sent to the Exchange's Trade Match System as a matched trade.

There would be two basic types of trade allocation methodologies: price-time and price-time pro rata. On top of these may be overlaid optional priorities for public customers, the Market Turner, and/or the SBT DPM/LMM.[14] The appropriate SBT Trading Committee would apply, for each class of options, one of the rules of trading priority discussed below. CBOE has stated that it would issue a Regulatory Circular periodically that would specify which priority rules would govern which classes of options any time the appropriate committee changed the priority.

*Price-Time Priority.* Under this method, resting orders in the SBT Book would be prioritized according to price and time. If two or more orders were at the best price, priority among these orders would be afforded in the order in which they were received by the System.

*Price-Time Pro Rata Allocation.*[15] Under this allocation methodology, resting orders in the SBT Book would be prioritized according to price. If there were two or more orders at the best price, trades would be allocated proportionally according to size (in pro rata fashion). The executable quantity would be allocated to the nearest whole number, with fractions ½ or greater rounded up and fractions less than ½ rounded down. If there were two market participants that were both entitled to an additional ½ contract and there were only one contract remaining to be distributed, the additional contract would be distributed to the market participant whose quote or order had time priority.

*Additional Priority Overlays.* In addition to the basic allocation methodologies set forth above, the appropriate SBT Trading Committee could determine to apply, on a class-by-class basis, any or all of the following designated market participant overlay priorities, in a sequence determined by the appropriate SBT Trading Committee.

(1) *Public Customer.* If this priority overlay were in effect and no other priority overlays were in effect, the highest bid and lowest offer would have priority, except that a public customer order would have priority over a non-public customer order at the same price. If other priority overlays were also in effect, priority would be established in the sequence designated by the appropriate SBT Trading Committee. In either case, if there were two or more public customer orders for the same options series at the same price, priority would be afforded to such public customer orders in the sequence in which they had been received by the System, even if the price-time pro rata allocation method were the chosen allocation method.

(2) *Market Turner.* If this priority overlay were in effect and no other priority overlays were in effect, the Market Turner would have priority at the highest bid or lowest offer that it had established. If other priority overlays were also in effect, priority would be established in the sequence designated by the appropriate SBT Trading Committee. In either case, the Market Turner priority at a given price would remain with the order once it had been earned. For example, if the market moved in the same direction as the direction in which the order from the Marker Turner had moved the market and then the market moved back to the Market Turner's original price, the Market Turner would retain priority at the original price.

(3) *Trade Participation Right (''TPR'').* SBT DPMs/LMMs could be granted trade participation rights that would provide for priority over non-public customer and/or customer orders up to the applicable participation right percentage designated pursuant to the provisions of proposed Chapter XLIV. If other priority overlays were also in effect, priority would be established in the sequence designated by the appropriate SBT Trading Committee. In allocating the participation right, all of the following would apply:

(i) To be entitled to its participation right, the order and/or quote of the SBT DPM/LMM would have to be at the best price.

(ii) An SBT DPM/LMM could not be allocated a total quantity greater than the quantity that the SBT DPM/LMM was quoting (including orders not part of quotes) at that price. Additionally, an SBT DPM/LMM could not be allocated a total quantity that represented a greater percentage than the SBT DPM's/LMM's percentage of the total size[16] at

[13] The Commission notes that a responsible broker or dealer is relieved of its firm quote obligations under CBOE Rule 8.51 as well as Rule 11Ac1–1 under the Act, 17 CFR 240.11Ac1–1 (''Firm Quote Rule''), if there are unusual market conditions such that the exchange is incapable of collecting, processing, and making available to quotation vendors the data required to be available under the Firm Quote Rule in a manner that accurately reflects the current state of the market on such exchange.

[14] The Commission notes that, under the proposed CBOE*direct* rules, public customers may not necessarily receive the highest allocation priority, depending on the priority structure authorized by the appropriate SBT Trading Committee. The Commission requests commenters views regarding the proposed rules that would govern allocation priority for CBOE*direct* transactions.

[15] In the draft notice prepared by CBOE, the ''Price-Time Pro Rata'' allocation method is sometimes referred to as ''Combined Price-Time and Size Priority.'' For the sake of clarity, only the term ''Price-Time Pro Rata'' is being used in this notice.

[16] ''Total size'' in this context means the quantity of contracts that would remain after the interest of any participant with a higher priority had been satisfied. Telephone conversation between Nancy Sanow, Ira Brandriss, and Michael Gaw, Division, Commission, and Angelo Evangelou, Legal Division, CBOE, on April 5, 2002 (''Telephone conversation of April 5, 2002'').

the best price before the participation right had been applied.

(iii) If the trade participation right priority and the Market Turner priority were both in effect and the SBT DPM/LMM were the Market Turner, the Market Turner priority would not be applicable.

(iv) In establishing the counterparties to a particular trade, the SBT DPM/LMM participation right would first be counted against the highest priority bids or offers of the SBT DPM/LMM.

*Contingency Orders.* Contingency orders would be placed last in priority order, regardless of when they were entered into CBOE*direct* or which allocation method was in place. A contingency order that was entered before a limit order for the same series at the same price would be treated as if it were entered after the limit order. If customer priority were afforded to a particular option class, customer contingency orders would have priority over non-public customer contingency orders.

*Spread Orders.* Spread orders would not be afforded priority according to proposed CBOE Rule 43.2, but would be handled as provided in proposed CBOE Rule 43.8.

Below are examples of how trades would be allocated under the different priority allocation methods.

*Price-Time Allocation*

*Example 1.* The SBT DPM's TPR share is 30%. In this example the allocation gives the DPM its TPR share only. Assume that, within the price-time allocation procedure, customer priority is specified as first and DPM as second. Assume that there is an incoming market order to sell 20.

*Book's Resting Bids:*

| Time | Category | Fill seq. | Bid qty. | Fills | DPM share n (30%) | DPM allocation | Remaining qty. | Notes |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | 20 | |
| 3 | Customer | 1 | 5 | 5 | | | 15 | |
| 8 | Customer | 2 | 1 | 1 | | | 14 | |
| 9 | Customer | 3 | 4 | 4 | | | 10 | |
| | | | | | 3.0 | 3 | 7 | 1 |
| 1 | MM1 | 4 | 10 | 7 | | | 0 | 2 |
| 2 | DPM bid1 | 5 | 10 | 3 | | −3 | | 3 |
| 4 | B/D1 | 6 | 10 | | | | | |
| 5 | DPM bid2 | 7 | 50 | | | | | |
| 6 | MM2 | 8 | 10 | | | | | |
| 7 | MM3 | 9 | 10 | | | | | |
| | Total | | 110 | | | | | |

*Notes*

1. The DPM TPR share is 30%. The DPM is allocated 3 contracts, leaving 7 for price-time allocation.

2. The first order, MM1, is partially filled with 7, leaving 0.

3. The DPMbid1 order is partially filled with 3 from the TPR allocation.

*Example 2.* The SBT DPM's TPR share is 30%. In this example, the allocation gives the DPM its TPR share plus a partial fill of its order in time sequence. Assume that, within the price-time allocation procedure, customer priority is specified as first and DPM priority as second. Assume that there is an incoming market order to sell 80.

*Book's Resting Bids:*

| Time | Category | Fill seq. | Bid qty. | Fills | DPM share n (30%) | DPM allocation | Remaining qty. | Notes |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | 80 | |
| 3 | Customer | 1 | 5 | 5 | | | 75 | |
| 8 | Customer | 2 | 1 | 1 | | | 74 | |
| 9 | Customer | 3 | 4 | 4 | | | 70 | |
| | | | | | 21.0 | 21 | 49 | 1 |
| 1 | MM1 | 4 | 10 | 10 | | | 39 | 2 |
| 2 | DPM bid1 | 5 | 10 | 10 | | −10 | 39 | 3 |
| 4 | B/D1 | 6 | 10 | 10 | | | 29 | 4 |
| 5 | MM2 | 8 | 10 | 10 | | | 19 | 5 |
| 6 | MM3 | 9 | 10 | 10 | | | 9 | 6 |
| 7 | DPM bid2 | 7 | 50 | 20 | | −11 | 0 | 7 |

*Notes*

1. The DPM's TPR share is 30%. The DPM is allocated 21 contracts, leaving 49 for price-time allocation.

2. The first non-customer order, MM1, is filled with 10, leaving 39.

3. The DPMbid1 order has been fully filled with 10 from the TPR allocation of 21. The quantity for price-time allocation remains unchanged at 39.

4. The B/D1 order is filled with 10, leaving 29.

5. The MM2 order is filled with 10, leaving 19.

6. The MM3 order is filled with 10, leaving 9.

7. The DPMbid2 order is partially filled with 20, which comes from the TPR remainder of 11 plus the remainder of 9.

*Example 3.* The SBT DPM's TPR share is 30%. In this example, the allocation gives the DPM its TPR share only. Assume that, within the price-time allocation procedure, customer priority is specified as first and DPM priority as second. Assume that there is an incoming market order to sell 80.

DPM share = 30% × 70 = 21.0

*Book's Resting Bids:*

| Time | Category | Fill seq. | Bid qty. | Fills | DPM share n (30%) | DPM allocation | Remaining qty. | Notes |
|---|---|---|---|---|---|---|---|---|
| | | | | | | 80 | | |
| 3 | Customer | 1 | 5 | 5 | | | 75 | |
| 8 | Customer | 2 | 1 | 1 | | | 74 | |
| 9 | Customer | 3 | 4 | 4 | | | 70 | |
| | | | | | 21.0 | 21 | 49 | 1 |
| 1 | MM1 | 4 | 10 | 10 | | | 39 | 2 |
| 2 | DPM bid1 | 5 | 10 | 10 | | −10 | 39 | 3 |
| 4 | B/D1 | 6 | 100 | 39 | | | 0 | 4 |
| 5 | DPM bid2 | 7 | 50 | 11 | | −11 | 0 | 5 |
| 6 | MM2 | 8 | 100 | | | | 0 | |
| 7 | MM3 | 9 | 10 | | | 0 | | |
| | Total | | 290 | | | | | |

*Notes*

1. The DPM TPR share is 30%. The DPM is allocated 21 contracts, leaving 49 for price-time allocation.
2. The first order, MM1, is filled with 10, leaving 39.
3. The DPM bid1 order is fully filled with 10 from the TPR allocation of 21. The quantity for price-time allocation is 39.
4. The B/D1 order is filled partially with 39, leaving 0.
5. The DPMbid2 order is partially filled with 11, which comes from the TPR remainder.

*Price-Time Pro Rata Allocation*

The SBT Book would store the orders from the best price to the worst. At each price level, the orders would be sorted in time sequence. Trades would be allocated in a manner that provided incentives to create deeper and tighter markets.

As discussed above, under the price-time pro rata allocation procedure, three optional priorities—customer priority, SBT DPM/LMM trade participation right, and Market Turner—could be specified, as well as their priority with respect to each other.

• *Customer Priority.* Customer priority, if it were provided, is recommended to be absolute. If customer priority were granted, customer orders would be filled ahead of any other order. Within the group of customer orders, the orders would be prioritized by time.

• *Market Turner.* The order that improves the market would earn Market Turner priority.

• *Trade Participation Rights.* To receive its TPR share, the SBT DPM/LMM would have to have a quote and/or order at the best price. The TPR would be calculated as a percentage—a minimum of *n* (30%)—of the remaining quantity after all higher priority orders (*e.g.,* customer) had been filled completely. The minimum TPR quantity would be allocated to the SBT DPM/LMM up to its size. If there were a remaining executable quantity, orders of lower priority than the SBT DPM/LMM (*e.g.,* Market Turner) would be filled completely. If there were remaining executable quantity, the remaining quote and/or order quantities of the SBT DPM/LMM, if any, would participate in the pro rata allocation of the remainder to the orders at the best price. However, the maximum participation quantity of the SBT DPM/LMM would be limited to its original pool share of the quantity before the minimum TPR quantity was calculated. In addition, if the Market Turner were an SBT DPM/LMM, that priority would be ignored. This algorithm is illustrated in examples 1 to 6 below.

*Price-Time Pro Rata Example 1.* Assume that priority is (1) customer, (2) DPM, (3) Market Turner. No customer orders are included to simplify the example. In this example, the Market Turner and the DPM are both filled, with the DPM getting less than its maximum possible allocation (*i.e.,* original pool percentage share). Note that the DPM has two orders. For this allocation method, the DPM size is aggregated and filled after the Market Turner is filled because the DPM gets its fill from a two-step allocation: First, from its TPR share and, second, from the pro rata calculation.

Assume there is an incoming market order to sell 20.

| Time | Category | Bid qty |
|---|---|---|
| 1 | MT | 10 |
| 2 | DPM bid1 | 15 |
| 3 | B/D1 | 20 |
| 4 | DPM bid2 | 50 |
| 5 | MM2 | 5 |
| 6 | MM3 | 10 |
| | Total | 10 |

| Category | Fill seq. | Bid qty | Bids for P.R. #1 | Pro rata alloc #1 | Fills | DPM 30% alloc. | Remaining qty | Notes |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | 20 | |
| | | | | | | 6 | 14 | 1 |
| MT | 1 | 10 | | | 10 | | 4 | 2 |
| DPM size | 2 | 65 | 59 | 3 | 9 | −6 | 1 | 3 |
| B/D1 | 3 | 20 | 20 | 1 | 1 | | 0 | 4 |
| MM2 | | 5 | 5 | 0 | 0 | | 0 | 4 |
| MM3 | | 10 | 10 | 0 | 0 | | 0 | 4 |
| Total | | 110 | 94 | 4 | 20 | | | |

DPM Pool % = (65/110) = 59.1%
DPM Max. Share, P = (65/110) × 20 = 11.8 or 12
DPM Min. Share, M = (0.3 × 20) = 6.0 or 6
Potential additional DPM share = 6

*Notes*

1. The DPM pool share is 65/110 or 59.1%, or a maximum allocation of 12 contracts. The DPM minimum TPR share is 30% of 20, or 6 contracts. The potential additional DPM share is (P–M), or (12 − 6) or 6 contracts. To begin,

the DPM TPR share of 6 is allocated, leaving 14.

2. The Market Turner is fully filled with 10, leaving 4.

3. The pro rata distribution of the remainder of 4 is calculated, using the remaining order sizes in the pool. The DPM's pro rata share is 3. Since 3 + 6 (M) is not greater than P(12), the pro rata shares are allocated. The DPM is allocated its pro rata share of 3.

4. B/D1 gets its pro rata share of 1. The other two orders get zero pro rata shares.

*Price-Time Pro Rata Example 2.* Assume that priority is (1) customer, (2) DPM, (3) Market Turner. No customer orders are included to simplify the example. In this example, the Market Turner and the DPM are both filled, with the DPM getting its maximum possible allocation (*i.e.,* original pool percentage share). Note that the DPM has two orders. For this allocation method, the DPM size is aggregated and filled after the Market Turner is filled.

Assume there is an incoming market order to sell 85.

| Time | Category | Bid qty. |
|---|---|---|
| 1 | MT | 10 |
| 2 | DPM bid1 | 15 |
| 3 | B/D1 | 20 |
| 4 | DPM bid2 | 50 |
| 5 | MM2 | 5 |
| 6 | MM3 | 10 |
| | Total | 110 |

| Category | Fill seq. | Bid qty. | Bids for P.R. #1 | Pro rata alloc. #1 | Bids for P.R. #2 | Pro rata alloc. #2 | Fills | DPM 30% alloc. | Remaining qty. | Notes |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 85 | |
| | | | | | | | | 26 | 59 | 1 |
| MT | 1 | 10 | | | | | 10 | | 49 | 2 |
| DPM size | 2 | 65 | 39 | 26 | | | 50 | −26 | 25 | 3 |
| B/D1 | 3 | 20 | 20 | 13 | 20 | 14 | 14 | | 11 | 4 |
| MM2 | 3 | 5 | 5 | 3 | 5 | 4 | 4 | | 7 | 4 |
| MM3 | 3 | 10 | 10 | 7 | 10 | 7 | 7 | | 0 | 4 |
| Total | | 110 | 74 | 49 | 35 | 25 | 85 | | | |

DPM Pool % = (65/110) = 59.1%

DPM Max. Share, P = (65/110) × 85 = 50.2 or 50

DPM Min. Share, M = (0.3 × 85) = 25.5 or 26

Potential additional DPM share = 24

*Notes*

1. The DPM pool share is 65/110 or 59.1%, or a maximum allocation of 50 contracts. The DPM minimum TPR share is 30% of 85, or 26 contracts. The potential additional DPM share is (P–M), or (50 − 26) or 24 contracts. To begin, the DPM TPR share of 26 is allocated, leaving 59.

2. The Market Turner is fully filled with 10, leaving 49.

3. The pro rata distribution of the remaining 49 is done. The DPM's pro rata share is 26. Giving the DPM 26 more would put its fill (26 + 26 = 52) greater than its original pool share of 50 (P). Therefore, the DPM is filled only up to 50. This takes 24 out of 49, leaving 25.

4. A second pro rata calculation is done to distribute the remainder of 25 to the non-DPM orders in the pool.

*Price-Time Pro Rata Example 3.* Assume that priority is (1) customer, (2) DPM, (3) Market Turner. No customer orders are included to simplify the example. In this example, the Market Turner and the DPM are both filled, with the DPM getting less than its minimum TPR of *n* (30%) because of its size. Note that the DPM has two orders. For this allocation method, the DPM size is aggregated and filled after the Market Turner is filled.

| Time | Category | Bid qty |
|---|---|---|
| 1 | MT | 20 |
| 2 | DPM bid1 | 10 |
| 3 | B/D1 | 35 |
| 4 | DPM bid2 | 10 |
| 5 | MM2 | 25 |
| 6 | MM3 | 10 |
| | Total | 110 |

| Category | Fill seq. | Bid qty. | Bids for P.R. #1 | Prorata alloc #1 | Fills | DPM 30% alloc. | Remaining qty. | Notes |
|---|---|---|---|---|---|---|---|---|
| | | | | | | | 85 | |
| | | | | | | 20 | 65 | 1 |
| MT | 1 | 20 | | | 20 | | 45 | 2 |
| DPM size | 2 | 20 | | | 20 | −20 | 45 | 3 |
| B/D1 | 3 | 35 | 35 | 23 | 23 | | 22 | 4 |
| MM2 | 3 | 25 | 25 | 16 | 16 | | 6 | 4 |
| MM3 | 3 | 10 | 10 | 6 | 6 | | 0 | 4 |
| Total | | 110 | 70 | 45 | 85 | | | |

DPM Pool % = (20/110) = 18%

DPM Max. Share, P = (20/110) × 85 = 15.5 or 16

DPM Min. Share, M = (0.3 × 85) = 25.5 or 26

Actual DPM share, limited by his size = 20

*Notes*

1. The DPM pool share is 20/110 or 18.2%, or a maximum allocation of 16 contracts. The DPM TPR share is 30% of 85, or 26 contracts. However, the DPM is allocated only up to its size of 20, leaving 65.

2. The Market Turner is fully filled with 20, leaving 45.

3. The DPM is filled with its allocation of 20. The remainder stays at 45 because 45 already account for the DPM allocation.

4. A second pro rata calculation is done to distribute the remainder of 45 to the non-DPM orders in the pool.

*Price-Time Pro Rata Example 4.* Assume that priority is (1) customer, (2) DPM, (3) Market Turner. No customer orders are included to simplify the example. In this example, the DPM is also the Market Turner. The Market Turner priority is ignored if the Market Turner order is a DPM order.

| Time | Category | Bid qty |
|---|---|---|
| 1 | DPM bid1 | 15 |
| 2 | B/D1 | 20 |
| 3 | DPM bid2 | 50 |
| 4 | MM2 | 15 |
| 5 | MM3 | 10 |
| | Total | 110 |

| Category | Fill seq. | Bid qty | Bids for P.R. #1 | Pro rata alloc #1 | Bids for P.R. #2 | Pro rata alloc #2 | Fills | DPM 30% alloc. | Remaining qty | Notes |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 85 | |
| | | | | | | | | 26 | 59 | 1 |
| DPM MT | 1 | 15 | | | | | 0 | | 59 | 2 |
| DPM size | 2 | 65 | 39 | 27 | | | 50 | −26 | 35 | 3 |
| B/D1 | 3 | 20 | 20 | 14 | 20 | 16 | 16 | | 19 | 4 |
| MM2 | 4 | 15 | 15 | 11 | 15 | 11 | 11 | | 8 | 4 |
| MM3 | 5 | 10 | 10 | 7 | 10 | 8 | 8 | | 0 | 4 |
| Total | | 110 | 84 | 59 | 45 | 35 | 85 | | | |

DPM Pool % = (65/110) = 59.1%
DPM Max. Share, P = (65/110) × 85 = 50.2 or 50
DPM Min. Share, M = (0.3 × 85) = 25.5 or 26
Potential additional DPM share = 24

*Notes*

1. The DPM pool share is 65/110 or 59.1%, or a maximum allocation of 50 contracts. The DPM minimum TPR share is 30% of 85, or 26 contracts. The potential additional DPM share is (P − M), or (50 − 26) = 24 contracts. To begin, the DPM TPR share of 26 is allocated, leaving 59.

2. Since the Market Turner is a DPM order, the Market Turner order of 15 is not filled, leaving 59.

3. The pro rata distribution of 59 is calculated. The DPM's pro rata share is 27. Giving the DPM 27 more puts its fill (26 + 27 = 53), greater than its pool share of 50. The DPM pro rata share is then limited to 24, leaving 35.

4. A second pro rata calculation is done to distribute the remainder of 35 to the non-DPM orders in the pool.

*Price-Time Pro Rata Example 5.* Assume that priority is (1) customer, (2) Market Turner, (3) DPM. No customer orders are included to simplify the example.

| Time | Category | Bid qty |
|---|---|---|
| 1 | MT | 10 |
| 2 | DPM bid1 | 15 |
| 3 | B/D1 | 20 |
| 4 | DPM bid2 | 50 |
| 5 | MM2 | 5 |
| 6 | MM3 | 10 |
| | Total | 110 |

| Category | Fill seq. | Bid qty | Bids for P.R. #1 | Pro rata alloc #1 | Bids for P.R. #2 | Pro rata alloc #2 | Fills | DPM 30% alloc. | Remaining qty | Notes |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 20 | |
| MT | 1 | 10 | | | | | 10 | 3 | 7 | 1 |
| DPM size | 2 | 65 | 62 | 5 | | | 7 | −3 | 3 | 2 |
| B/D1 | 3 | 20 | 20 | 1 | 20 | 2 | 2 | | 1 | 3 |
| MM2 | 4 | 5 | 5 | 0 | 5 | 0 | 0 | | 1 | 3 |
| MM3 | 5 | 10 | 10 | 1 | 10 | 1 | 1 | | 0 | 3 |
| Total | | 110 | 97 | 7 | 35 | 3 | 20 | | | |

DPM Pool % = (65/100) = 65.0%
DPM Max. Share, P = (65/100) × 10 = 6.5 or 7
DPM Min. Share, M = (0.3 × 10) = 3.0

*Notes*

1. The Market Turner is fully filled with 10, and the DPM is allocated its 30% or 3, leaving a remainder of 7.

2. The pro rata distribution of the remaining 7 is done. The DPM's pro rata share is 5. Giving the DPM 5 more would put its fill (3 + 5 = 8) greater than its original pool share of 7 (P). Therefore, the DPM is filled only up to 7. This takes 4 from 7, leaving 3.

5. A second pro rata calculation is done to distribute the remainder of 3 to the non-DPM orders in the pool.

*Price-Time Pro Rata Example 6.* Assume that priority is (1) customer, (2) Market Turner, (3) DPM. No customer orders are included to simplify the example. In this case, the DPM's original pool share is less than its minimum 30% TPR share. The DPM's participation is limited to the 30% TPR share.

| Time | Category | Bid qty |
|---|---|---|
| 1 | MT | 10 |
| 2 | DPM bid1 | 10 |
| 3 | B/D1 | 20 |
| 4 | DPM bid2 | 10 |
| 5 | MM2 | 50 |
| 6 | MM3 | 10 |
| | Total | 110 |

| Category | Fill seq. | Bid qty | Bids for P.R. #1 | Pro rata alloc #1 | Bids for P.R. #2 | Pro rata alloc #2 | Fills | DPM 30% alloc. | Remaining qty | Notes |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | 20 | |
| MT | 1 | 10 | | | | | 10 | 3 | 7 | 1 |
| DPM size | 2 | 20 | 17 | 1 | | | 3 | −3 | 7 | 2 |
| B/D1 | 3 | 20 | 20 | 2 | 20 | 2 | 2 | | 5 | 3 |
| MM2 | 4 | 50 | 50 | 3 | 50 | 4 | 4 | | 1 | 3 |
| MM3 | 5 | 10 | 10 | 1 | 10 | 1 | 1 | | 0 | 3 |
| Total | | 110 | 97 | 7 | 80 | 7 | 20 | | | |

DPM Pool % = (20/100) = 20.0%
DPM Pool Share, P = (20/100) × 10 = 2.0
DPM Min. Share, M = (0.3 × 10) = 3.0

*Notes*

1. The Market Turner is fully filled with 10, and the DPM is allocated its 30% or 3, leaving a remainder of 7.

2. The pro rata distribution of the remaining 7 is done. The DPM's pro rata share is 1. Giving the DPM 1 more would put its fill (3 + 1 = 4), greater than its original pool share of 2 (P) or its TPR share of 3. Therefore, the DPM gets zero additional contracts.

3. A second pro rata calculation is done to distribute the remainder of 7 to the non-DPM orders in the pool.

*Pro Rata Calculation Example. Remaining quantity of 49 is to be allocated to four orders as shown below.*

Alloc. % = (Order Qty × 100/Total Order Qty)

Calc. Qty = (Alloc. %) × Remaining Quantity

Alloc. Qty = Calc. Qty rounded up/down

In each step the allocated quantity is determined for one order. See the Final Allocations where the ''Calc. Qty'' is rounded up/down to the ''Alloc. Qty.'' In the last step, the ''Alloc. Qty'' for the two last orders is determined.

| | | Order 1 | Order 2 | Order 3 | Order 4 | Total order qty | Remaining qty to allocate |
|---|---|---|---|---|---|---|---|
| Step 1 | Order qty | 20 | 39 | 5 | 10 | 74 | 49 |
| | Alloc. % | 27.0 | 52.7 | 6.8 | 13.5 | | |
| | Calc. qty | 13.2 | 25.8 | 3.3 | 6.6 | | |
| Step 2 | Order qty | | 39 | 5 | 10 | 54 | 36 |
| | Alloc. % | | 72.2 | 9.3 | 18.5 | | |
| | Calc. qty | | | | 26.0 | 3.3 | 6.7 |
| Step 3 | Order qty | | | 5 | 10 | 15 | 10 |
| | Alloc. % | | | 33.3 | 66.7 | | |
| | Calc. qty | | | 3.3 | 6.7 | | |
| Final Allocations | | | | | | | |
| Step 1 | Alloc. qty | 13 | | | | 13 | |
| Step 2 | Alloc. qty | | 26 | | | 26 | |
| Step 3 | Alloc. qty | | | 3 | 7 | 10 | |
| | | | | Total allocated qty = | | 49 | |

d. Crossing Orders

*Interim Procedure.* Initially, an SBT Trader would be able to cross orders only after giving all other market participants an opportunity to trade against the orders. Pursuant to proposed CBOE Rule 43.12A, if an SBT Broker held orders to buy and sell the same option series and wanted to cross such orders, the SBT Broker would first have to send an RFQ with the size of the orders to be crossed. The RFQ response period would be for a period of time established by the appropriate SBT Trading Committee and initially would be set at 30 seconds.[17]

At the end of this RFQ response period and by the end of a second time period of 20 seconds or some other duration as established by the appropriate SBT Trading Committee, the SBT Broker would have to expose one of the orders to the SBT Book. If the SBT Broker had two customer orders to cross, the broker would use his or her discretion to determine which of the orders to expose to the SBT Book. Both orders would receive price improvement, however, because the cross would have to be consummated between the best bid and offer. After the SBT Broker had entered the order to be exposed on the book, other SBT Traders would have a specified time period in which to trade against it. This time period would be established by the appropriate SBT Trading Committee and initially would be set at ten seconds.[18] If the exposed order were not completely taken out by other SBT Traders at the end of this period, the SBT Broker could enter the opposite order to cross any balance of the exposed order that remained.[19]

An SBT DPM/LMM would not be entitled to receive its participation right on a cross transaction executed pursuant to proposed CBOE Rule 43.12,

[17] CBOE has advised that it intends to amend the proposed rule change to establish a minimum time period for response to the RFQ. Telephone conversation of April 5, 2002.

[18] *Id.*

[19] *Id.*

*Crossing Mechanism*, or 43.12A, *Interim Crossing Procedure*, because the trade would necessarily occur at a price between the best bid and offer previously established.

It would be a violation of proposed CBOE Rule 43.12 (described below) or of proposed CBOE Rule 43.12A for an SBT Broker to be a party to any arrangement designed to circumvent CBOE Rule 43.12 or Rule 43.12A by providing an opportunity for a customer to regularly execute against agency orders handled by the SBT Broker immediately upon their entry into the System.

It also would be a violation of proposed CBOE Rules 43.12 or 43.12A for an SBT Broker to cause the execution of an order it had represented as agent on the Exchange by orders it solicited from members and non-member broker-dealers to transact with such orders, whether such solicited orders were entered into the System directly by the SBT Broker or by the solicited party (either directly or through another member), if the member failed to expose orders on the Exchange as required by proposed CBOE Rules 43.12 or 43.12A.

CBOE has represented that it would surveil for instances where an SBT Broker had entered orders that were executed against each other without being executed pursuant to proposed CBOE Rules 43.12 or 43.12A. CBOE believes that this activity would be relatively simple for it to identify.

*Crossing Mechanism.* CBOE has stated that the System would eventually provide for a participation right for SBT Brokers wishing to cross orders. Once the System has been enabled to provide for such right, the Crossing Mechanism would be a process by which an SBT Broker could facilitate an original order or cross two original orders.[20] The Crossing Mechanism would permit an SBT Broker, after requesting and receiving a market from other SBT Traders through the RFQ process, to cross a guaranteed percentage of an original customer order with a facilitation order or second customer order at a price that improved upon the market that the SBT Broker had received. The Crossing Mechanism would then expose the remaining portion of the original order to other SBT Traders, giving them an opportunity to trade against it, ahead of the SBT Broker, within a specified time period of 20 seconds.

As with the Interim Procedure, to use the Crossing Mechanism, an SBT Broker would first have to submit to the System an RFQ designating a size equal to the quantity to be crossed. SBT Traders would then have an RFQ response period for a length of time established by the SBT Trading Committee to enter orders or quotes that matched or improved upon the existing quotations on the System.[21]

At the end of the RFQ response period and by the end of the second time period to be established by the SBT Trading Committee (likely to be 20 seconds), the SBT Broker would have to enter the terms of the proposed cross transaction.[22] The required terms would include the terms of the original order and the proposed facilitation order (or two original orders), a proposed crossing price, the quantity of the original order that the SBT Broker would be willing to facilitate (in the case of a facilitation cross), and an indication of which order is to be exposed to the market (in the case of a cross of two original orders)—*i.e.*, after the guaranteed crossing percentage had been applied as described below. The customer order would be the exposed order in a facilitation cross.

The following two conditions would have to be satisfied at the time the cross transaction was entered or the System would reject the cross transaction: (1) A legal width market would have to exist for the particular series to be crossed, and (2) the proposed cross price would have to be between the best bid and offer displayed by the System.

If all the terms were properly entered and the two aforementioned conditions were satisfied, the System would immediately cross the two orders up to the amount of the guaranteed crossing percentage (*i.e.*, 40%) of the crossing quantity. For example, if the crossing quantity were 1,000 and the guaranteed crossing percentage were 40%, the System immediately would trade 400. After this immediate execution of the guaranteed percentage of the cross, the System would expose the remaining volume of the original customer order in the SBT Book at the same price for a period of 20 seconds.[23] During this period, the other SBT Traders would be given the opportunity to trade against the remaining 60% of the original order ahead of the submitting SBT Broker, while the System placed the opposite order on hold as a shadow order that would not be visible except to the submitter.[24] The exposed order's price and quantity would be disclosed but the System would not indicate that the order was part of an overall crossing transaction, 40% of which had already been executed, and the remaining part of which would be pending as a cross of the exposed order with the shadow order.[25]

As long as the exposed order was the highest priority order at the best price, other SBT Traders could trade against the exposed order during the 20-second exposure period. If the exposed order were fully filled by other traders, the System would cancel the remaining quantity of the shadow order and send the crossing firm a message that the crossing transaction was completed.

At the end of the exposure period, if the exposed order had quantity remaining and if it were at the best price and had the highest priority, the System would fill the remainder of the order with the shadow order. The System would cancel the remaining quantity of the shadow order and send the crossing firm a message that the crossing transaction was completed. If the exposed order had quantity remaining and it were not the highest priority order at the market (*i.e.*, it were not the highest bid/lowest offer), the System automatically would cancel the remainder of the exposed order and send the SBT Broker a message that the crossing transaction was completed.

For example, assume the exposed (customer) order buy quantity is 1,000 and 500 were filled before the end of the exposure period. If the order were at the best price and had the highest priority, the remaining 500 would be filled by the shadow (firm) order at the crossing price. However, if the exposed order were not at the best price or did not have the highest priority at its price, the remaining 500 of the exposed order would be canceled.

Proposed CBOE Rule 43.12A would apply until the System has been enabled to provide for this Crossing Mechanism.

[20] CBOE has advised that it intends to amend the proposed rule change to establish a minimum eligible order size for transactions using the Crossing Mechanism. *Id.*

[21] CBOE has advised that it intends to amend the proposed rules change to establish a minimum time period for response to the RFQ. *Id.*

[22] *Id.*

[23] In the example above, the System would show only an order for 600 contracts, and the original size of 1,000 would not be exposed to the other SBT Traders. However, a trade of 400 contracts at the crossing price would appear on the tape of the reported trades.

[24] CBOE has advised that it intends to amend the proposed rule change to incorporat e an interpretation advising that it would be a violation of an SBT Trader's duty of best execution to its customer if it were to cancel a crossing transaction to avoid execution of the order at a better price. Telephone conversation of April 5, 2002.

[25] *Id.*

e. Market Order Processing

Proposed CBOE Rule 43.7 would govern the processing of market orders on CBOE*direct*. CBOE has stated that, in developing the market order processing rules, it sought to balance two customer protection interests: (1) Ensuring that an order is executed against current quotes, and (2) ensuring that an order is executed quickly.[26] To ensure the order is executed against current quotes, the System would protect a market order by automatically executing it against the best bid/ask only if there were a legal width market.[27] The System would match market orders against orders at the best price in the SBT Book and against the other orders behind the best price at varying prices until, after trading against the bids or offers, a legal width market no longer existed.

If there were no legal width market when the order was entered in the System, or if any portion of the market order were not executed because there were no longer a legal width market, the System would hold the order (or any remaining portion of the order) in queue, send an RFQ to SBT Market Makers currently providing quotes, and send a notice to the originator of the order about the order status.

An RFQ sent pursuant to these procedures would include the market order quantity but not whether the order was a buy or a sell. RFQ responses would be sent to the SBT Book. From this point, the System would attempt to execute the market order if any one of the following conditions became true (as specified in proposed CBOE Rule 43.7):[28]

1. During the RFQ expiration response time, if the best quote width became a certain prescribed percentage (*e.g.*, 75%)—as set by the appropriate SBT Trading Committee—of the legal width market.[29]

2. If an incoming immediately executable limit order were received on the same side of the market as the market order and at least one legal width quote were received.[30]

3. If a certain prescribed percentage of the market makers currently providing quotes in the class—the percentage to be set by the appropriate SBT Trading Committee—had responded to the RFQ.

4. If the RFQ period expired and there were at least one quote response.

5. If one or more market orders were entered on the opposite side and there were a legal width market at the time the particular order arrived.

If any of the above conditions were met, the System would execute the market order against orders in the SBT Book or immediately against an incoming market order on the opposite side. If there were volume remaining in the market order, the System would hold it in queue and repeat the RFQ cycle. The System also would send a notice to the originator of the order status and give the originator the option to cancel the order.

If the RFQ period expired and there were no RFQ response, the System would send an alert message to the Help Desk. The Help Desk could solicit quotes from the SBT Market Makers and require a response from them.

The following describes the price at which the System would execute the market order. If the System were executing the market order against a market order that had been entered on the opposite side at the time a legal width market was present, the System would cross the market orders at a price between the bid and offer, as further described in proposed CBOE Rule 43.7.

If an incoming RFQ response could execute against a market order as well as older limit orders (at a particular price), then:

1. If the incoming RFQ response were of large enough quantity to fill all the older limit orders and the market order, all of those orders would be filled at the price of the older limit orders.

2. If the incoming RFQ response were not large enough to fill all of the older limit orders, the market order would be executed at the minimum price interval ahead of the older limit orders.[31]

If a market order for a certain series became subject to an RFQ as described above, then subsequent market orders for the same series and side would be queued to ensure that these incoming market orders were processed in time sequence.

If trading were halted while a market order was on hold waiting for RFQ responses, the SBT System would do the following:

1. If the market order were a GTC order, the System would hold and execute it at the next opening, in the same day or the next day.

2. If the market order were a day order, the System would execute it at re-opening if trading resumed for the same day.

3. If trading did not resume, the System would purge the market order as part of the end-of-day procedure for purging day orders.

*Market Order Processing Examples*

*Example 1.* When the System receives a market order, it would check for the presence of a legal width market. If there were no legal width market, the System automatically would hold the market order in queue and send an RFQ. If a legal width market existed, the market order would execute against the best order in the SBT Book and against the other orders behind the best, at varying prices until the market order was fully filled or until a legal width market no longer existed.

Assume there are six SBT Market Makers assigned to the product. The maximum allowable quote width, and the legal width market, for a bid range of $5.01 to $10.00 is $0.50. The SBT Book looks as follows:

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 5 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

A market order to buy 35 arrives.

Since a legal width market exists ($6.75 - 6.25 = 0.50$), the market order is filled with 10 at 6.75, leaving 25 to be executed. Now, the market width is no longer standard ($6.90 - 6.25 = 0.65$, *i.e.*, wider than the 0.50 allowed). The System places the remaining 25 contracts of the market order on hold and automatically issues an RFQ for a quantity of 25.

The System reports the best quote to OPRA as $6.25 - 6.90$, $5 \times 20$. The market order is not exposed in the SBT Book. The book now looks as follows:

[26] In most cases, at least if the System were used during an RTH session, market orders would execute immediately because CBOE expects there would be a legal width market for most series at most times.

[27] A pair of unrelated bid and offer orders, whose sizes may be less than the minimum quote size, separated by the Exchange-prescribed width, would be sufficient to trigger the trade of an incoming market order. It would not be necessary to have a standard quote (*i.e.*, a pair of bid and ask orders that are part of the same quote) meeting the minimum quote size and the prescribed width requirements.

[28] In determining to provide for an execution upon the occurrence of any of these particular events, CBOE sought to balance the interests of the Exchange's customers in receiving a quick and certain execution against the desire of the Exchange and the interests of its customers in ensuring that executions occur only in circumstances where there is a high level of market participation and/or liquidity.

[29] CBOE believes that this condition would help to minimize the queuing time of the market order.

[30] CBOE believes that this condition would prevent the later-arriving limit order from executing ahead of the market order, thus preserving time priority. Under this condition, if no quote had been received, the limit order would execute ahead of the market order.

[31] CBOE believes that this condition would prevent a violation of time priority because the market order would be executed at a price to which the limit order would not be entitled.

MARKET ORDER FOR 25

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| 5 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

*Example 2.* The System would expose the incoming quotes (*i.e.*, RFQ responses) in the SBT Book. During the RFQ expiration time, if the best quote width became the designated percentage of the legal quote width (*e.g.*, 75%) or less, the System would execute the market order against the quote and any other eligible booked order until the order were fully filled or until the legal width market no longer existed. If the latter occurred, the System would hold the market order in queue again, send an RFQ, and send a notice to the originator about the order status.

Continuing with the example from above, assume the first quote, $6.25-6.75$, $10\times10$, arrives. The market order does not trade even if the market is legal width ($6.75-6.25=0.50$) because none of the requirements is met. The market width is not 75% (assuming this is the designated percentage) or less of the legal width market. In addition, 50% (*i.e.*, 3) or more of the market makers have not responded. Finally, the RFQ response time has not expired. This rule would protect the market order by ensuring that it did not trade against the first quote that came in that could have a standard width yet be off the market expressed by the other market makers. The System reports the best quote to OPRA as $6.25-6.75$, $15\times10$.

The SBT Book now looks as follows:

MARKET ORDER FOR 25

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 5 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

Now assume a second quote, $6.25-6.55$, $10\times10$ arrives. Since the market width is now 0.30 (*i.e.*, 60% of the legal width market), the market order trades with the best order on the opposite side and any other orders behind it, until the market width is no longer standard. The market order is filled for 10 at 6.55, then for 10 more at 6.75.[32] The System then automatically issues a second RFQ for the remaining quantity of 5. The System reports the best quote to OPRA as $6.25-6.90$, $25\times20$. The book now looks as follows:

MARKET ORDER FOR 5

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| 25 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

Now assume that a quote, $6.25-6.75$, $10\times10$, arrives. Again, the market order does not trade even if a legal width market exists. Only one market maker of six has responded. The quote width is not 75% or less of the legal width market. The System reports the best quote to OPRA as $6.25-6.75$, $35\times10$. The book now looks as follows:

MARKET ORDER FOR 5

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 35 | 6.25 | ..... | ..... |
| 25[33] | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

*Example 3.* If the System received a limit order on the same side of the market as the market order that could match the best bid/offer and at least one quote had been received, creating a legal width market, the System would execute the market order against the best bid/offer. The market order would trade ahead of the just-arrived limit order because it had time priority. The presence of a legal width market coupled with a limit order on the same side as the market order, ready to trade against the best opposite side order, would protect the market order from trading at an unreasonable price. If there were no legal width market, the market order would be ''protected'' from trading and the limit order would be filled ahead of the market order.

Continuing with the example above, assume a limit order to buy 10 at 6.75 arrives. The buy limit order matches the best offer and there is a legal width market. Therefore, the market order trades against 5 of the best offer of 6.75. The limit order to buy then trades with the remaining 5 offered at 6.75. The System reports the best quote to OPRA as $6.75-6.90$, $5\times20$. The book now looks as follows:

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| 5 | 6.75 | ..... | ..... |
| 35 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

*Example 4.* If an incoming RFQ response could execute against a market order as well as older limit orders (*i.e.*, limit orders that were on the SBT Book before the market order was entered) at a particular price, then, if the incoming RFQ response were of large enough quantity to fill all the older limit orders and the market order, all of those orders would be filled at the price of the older limit orders.

Assume that a market order for 5 is on hold and that the bids for 6.25 are older than the market order. Assume that the book looks as follows:

MARKET ORDER FOR 5

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 35 | 6.25 | ..... | ..... |
| 25 | 6.15 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

Now assume that a quote of $6.00-6.20$, $50\times50$ arrives. The market is crossed for an instant at $6.25-6.20$, $35\times50$. The System does not report this instantaneous best quote to OPRA. It will send a best quote report after the cross is traded out (which will happen immediately). Since the 50 offered at 6.20 could fill all the limit orders to buy at 6.25 and the market order (total quantity of 35+5) at 6.25, then the market order is filled at 6.25. When the market is crossed the execution price is the price of the older order. The System reports the best quote to OPRA as

[32] CBOE believes that it is appropriate for a portion of the balance of the market order to execute at a price outside of the designated percentage of the legal width market in accordance with the market order processing procedures because, among other things: (1) An opportunity was provided for additional market participants to submit quotes priced within the designated percentage of the legal width market; (2) continuing to hold the balance of the order would cause unnecessary queuing of marketable orders; and (3) under CBOE market order processing procedures, no portion of the market order would be executed outside of a legal width market. Further, CBOE notes that, for multiply listed option classes, NBBO considerations would also protect the market order. E-mail from Angelo Evangelou, Legal Division, CBOE, to Michael Gaw, Division, Commission, dated November 13, 2001.

[33] Exhibit 1 of Amendment No. 1 contains a typographical error, and this figure was incorrectly reported as 30. CBOE has confirmed that 25 is in fact the correct figure. Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Michael Gaw, Division, Commission, on November 9, 2001.

6.15 − 6.20, 25 × 10. The book now looks as follows:

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| | | 6.20 | 10 |
| 25 | 6.15 | ..... | ..... |
| 50 | 6.00 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

*Example 5.* If an incoming RFQ response were not large enough to fill all the older limit orders, the market order would be executed at the minimum price interval ahead of the older limit orders. Executing at a better price would enable the market order to trade ahead of the older limit order, thus preserving time priority.

Assume that there is a market order to buy 5 on hold and that the bids at 6.25 are older than the market order. Assume that the book looks as follows:

MARKET ORDER OF 5

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 35 | 6.25 | ..... | ..... |
| 25 | 6.15 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

Now assume that a quote 6.00 − 6.25, 10 × 10 arrives. The market is locked for an instant at 6.25 − 6.25, 35 × 10. The System does not report the instantaneous best quote to OPRA (because the quote will be traded instantly). The System will send a best quote report after the locked market is traded out. Because the 10 traded at 6.25 could not fill all the limit orders to buy at 6.25 and the market order (total quantity of 35 + 5 = 40) at 6.25, then the market order is filled at 6.30, one minimum tick ahead of the older limit orders at 6.25.[34] The remaining 5 offered at 6.25 trades with 5 of the older limit orders to buy at 6.25. The System reports the best quote to OPRA as 6.25 − 6.75, 30[35] × 10. The resulting book looks as follows:

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 30[36] | 6.25 | ..... | ..... |
| 25 | 6.15 | ..... | ..... |
| 10 | 6.00 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

*Example 6.* If the older limit order is a Fill or Kill (''FOK'') order or an All or None (''AON'') contingency order and the just-arrived order could trade with the contingency order, the market order would be executed at the price of the contingency order. The market order need not trade at a minimum price interval to step ahead of the older contingency order because contingency orders would have to yield priority to market orders even if they were received before the market order.

Assume that there is a market order to buy 5 on hold. Assume that the 10 bid at 6.25 is older than the market order and that this bid is a FOK or an AON contingency order. The System reported the best quote to OPRA as 6.20 − 6.75, 25 × 10. Note that the FOK or AON contingency order does not affect the best quote report sent to OPRA. Only limit orders and IOC orders are reflected in the best quote report sent to OPRA. Assume the book looks as follows:

MARKET ORDER FOR 5

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| 10 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

Now assume that a quote 6.00 − 6.25, 10 × 10 arrives. Because the 10 offered at 6.25 could not fill all the older limit orders and the market order (total quantity of 10 + 5 = 15) at 6.25, the market order is filled at 6.25, at the price of the contingency order. Now the book looks as follows:

| Book bid size | Book bid | Book ask | Book ask size |
|---|---|---|---|
| | | 6.95 | 5 |
| | | 6.90 | 20 |
| | | 6.75 | 10 |
| | | 6.25 | 5 |
| 10 | 6.25 | ..... | ..... |
| 25 | 6.20 | ..... | ..... |
| 10 | 6.00 | ..... | ..... |
| 5 | 5.95 | ..... | ..... |

The book is displayed as locked because the 10 AON or FOK bid at 6.25 has to be filled in its entirety. Note that only the SBT Traders using the System are aware of this lock condition. The System reports to OPRA a best quote of 6.20 − 6.25, 25 × 5.

To summarize, if the designated percentage (*e.g.*, 50%) of the assigned market makers had responded to the RFQ or if the RFQ period had expired and there were at least one standard quote response, the System would execute the market order against the book. If there were volume remaining in the market order, the System would hold it in queue and repeat the RFQ cycle. The System also would send a notice to the originator of the order status and give the originator the option to cancel the order.

If the RFQ expired and there were no RFQ response, the System would continue to hold the market order, repeat the RFQ cycle, send a notice to the originator about the order status, and send an alert message to the Help Desk about the lack of an RFQ response. The originator of the order could cancel the order if the originator wished. The Help Desk would contact the assigned market makers.

If the market order could be executed under the conditions cited above and there were one or more market orders on the opposite side, the System would cross the market orders at a price determined as follows:

1. At the middle of the best bid/offer in the book if the middle price were a legal price (*i.e.,* a price that could be quoted in the System).

2. If the middle price were not a legal price, at the next legal price from the middle that was closer to the last trade price of the product.

f. Limit Order Processing

Until CBOE*direct* is enabled to provide price protection under proposed CBOE Rule 43.8A, after the opening, upon being entered into the System, limit orders would be matched against the best prices available in the SBT Book under the priority rules set forth in proposed CBOE Rule 43.1. If there were no orders in the SBT Book that matched the limit order when it was entered, the limit order would be held in the book and could be traded against later submitted orders.

When CBOE*direct* is enabled to provide price protection, the System would protect limit orders by automatically executing the limit order against the best bid/ask only if one or both of the following conditions were met:

1. A legal width market existed for that series; or

2. The limit price on the order was between the bid of the series with the same expiration month and one strike price lower and the offer of the series

[34] CBOE assumes the minimum tick for purposes of this example is $0.05.

[35] Exhibit 1 of Amendment No. 1 contains a typographical error, and this figure was incorrectly reported as 35. CBOE has confirmed that 30 is in fact the correct figure. Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Michael Gaw, Division, Commission, on November 9, 2001.

[36] 36 *See id.*

with the same expiration month and one strike price higher, and a legal width market existed for both of these series.

*Example:* Assume the SBT Book looks like the following:

| Series | Size | Bid | Ask | Size |
|---|---|---|---|---|
| July 50 | 10 | *10 | 11 | 20 |
| July 55 | ..... | ..... | 9.75 | 10 |
| July 60 | 50 | 1.5 | *1.75 | 25 |

*The marked (*) prices set the range for an acceptable execution price.

A limit order to buy 10 July 55s at 9.75 is entered. This trade would be executed at 9.75 because the price of execution is between the bid of the July 50s (the next lower strike) and the offer of the July 60s (the next higher strike).

If a limit order could execute against the best bid/ask and neither of the conditions set forth above were met, a message would be sent stating that an RFQ would be generated. The RFQ would include the order quantity, but not whether the order was a buy or sell. Quote responses would be exposed in the book as they were received. The SBT Trader linked to CBOE*direct* through the API could direct the System to override the RFQ and determine to enter the limit order into the SBT Book and possibly trade against standing orders or subsequent orders in the book, although there might not be a legal width market at the time. If the limit order's price prevented it from matching with the best bid/ask, the System would place the order in the SBT Book in its appropriate priority position.

Subject to the details set forth in proposed CBOE Rule 43.8A, when the limit order price protection feature has been implemented, the System would execute the limit order after either one of the following conditions became true:

1. During the RFQ response time, if the best quote width became a certain prescribed percentage (*e.g.,* 75%)—as set by the appropriate SBT Trading Committee—of a legal width market, the System would execute the limit order against the quote and any other eligible booked order.

2. If an incoming market or limit order were received (independent of the RFQ responses) on the opposite side that would match the original limit order and if a legal width market existed for the series, the System would match the limit order with the incoming order.

3. When a certain prescribed percentage of the SBT Market Makers currently providing quotes in that class—the percentage to be set by the appropriate SBT Trading Committee—had responded to the RFQ, or when the RFQ period expired and there were at least one quote response, the System would execute the limit order against the SBT Book.

If a limit order for a certain series were queued, subsequent limit orders for the same series and side would be queued behind the first one to ensure that they were processed in time sequence. Market orders for the same series and side would be queued. If a legal width market remained upon completion of limit order processing, the market order would be executed against orders resting in the book. If there were not a legal width market, market order processing would begin in accordance with Exchange rules.

g. Contingency Order Processing

CBOE has asserted that CBOE*direct* eventually would be enabled to handle a number of types of contingency orders pursuant to the terms of proposed CBOE Rule 43.9. A contingency order that had been entered before a limit order with no contingency at the same price and for the same series would nonetheless be treated as if it were entered after that limit order. The System would notify the originator of the order if the contingency order expired or were canceled. The System would handle the following contingency orders as described below once it had been enabled to handle such contingency orders.

1. *Opening Only Order.* The System would accept an opening only order only during the Pre-opening, Halted, or Closed states. The order would be executed during the Opening state if there were orders to execute it against. The order or any unexecuted portion thereof would expire after the opening trade or after the opening quote had been disseminated.

2. *All or None Order.* An AON order would be executed only if it could be executed in its entirety. The order would remain in the book until filled or canceled. An AON order would not be disseminated as part of the best bid/ask.

3. *Fill or Kill Order.* An FOK order has a time contingency and would have to be fully filled within a period of time, or the System automatically would cancel the order. The System would attempt to execute the full quantity of the FOK order upon receipt. If the FOK order were at the best price and there were a legal width market, and it could not be filled fully, the System would indicate its presence to SBT Traders by displaying its quantity for the Time Contingency Period as determined by the appropriate SBT Trading Committee. If the FOK order did not equal or better the market (i.e., if it were a buy order lower than the best bid or a sell order higher than the best offer), the System would reject the order.

4. *Immediate or Cancel (''IOC'') Order.* An IOC order has a time contingency and would have to be filled fully or partially within a period of time, or the System automatically would cancel the remainder. If the IOC order were at the best price and there were a legal width market, and it could not be filled fully, the System would indicate its presence to SBT Traders by displaying its quantity for the Time Contingency Period as determined by the appropriate SBT Trading Committee. If the IOC order did not equal or better the market (*i.e.,* if it were a buy order lower than the best bid or a sell order higher than the best offer), the System would reject the order. The System would cancel the residual order volume after the IOC process period, if the IOC order had not been executed completely.

5. *Minimum Volume (''MIN'') Order.* A MIN order could be accepted by the System at any time. A MIN order would have two quantities specified: the total quantity and the minimum acceptable quantity that can be filled. The fill would have to equal at least the minimum quantity specified. The System would attempt to execute at least the minimum volume specified against orders in the book. If the minimum volume were not executed, the order would remain in the book.

6. *Stop Order.* A stop order to buy becomes a market order when the product trades or is bid at or above the stop price. A stop order to sell becomes a market order when the product trades or is offered at or below the stop price. The System would not display a stop order to anyone other than the originator of the order, except as part of the contingency count in the book depth information.

7. *Stop Limit Order.* A stop limit order has two prices: the stop limit price and

the limit price. A stop limit order to buy becomes a limit order at the second price when the product trades or is bid at or above the stop limit price (first price). A stop limit order to sell becomes a limit order at the second price when the product trades or is offered at or below the stop limit price (first price). The System would not display a stop limit order to anyone other than the originator of the order, except as part of the contingency count in the book depth information.

8. *Market On Close (''MOC'') Order.* An MOC order is executable only during some defined period of time prior to the close. If there were no legal width market when an MOC was received, an RFQ would be sent at a certain amount of time before the Closing, as determined by the appropriate SBT Trading Committee. If no RFQ response were received, the order would be canceled after Closing.

h. Processing of Spread Orders

Proposed CBOE Rule 43.10 would govern the processing of spread orders. The System initially would support the following types of spread orders (''Spread Orders'') only:

1. Two-legged spreads where the ratio is 1:1 and 1:2;

2. Three-legged spreads where the ratio is 1:1:1 or 1:2:1;

3. Four-legged spreads where the ratio is 1:1:1:1; and

4. Any other spread type approved by the appropriate SBT Trading Committee.

The System would treat each spread order as a unique product and would assign each a unique product name. The System would maintain a book for every unique spread product with bids and offers for individual spread packages. The System would keep track of and disseminate internally the best bid and offer for every unique spread to SBT Traders.

i. Processing of Requests for Quotes

Proposed CBOE Rule 43.11 would govern the processing of RFQs. Any SBT Trader could initiate an RFQ for a series. The SBT Trader could specify a size at his or her option but would not specify whether the RFQ is for a buy or sell. The System would send the RFQ to the SBT Market Makers who were currently providing quotes in that class. The System also would automatically send an RFQ when it received a market order and the current market width was wider than the Exchange-prescribed width, as set forth in proposed CBOE Rule 43.5.

An RFQ would have an expiration period for the SBT Market Makers to respond. SBT Market Makers would be required to respond to RFQs in accordance with obligations set forth in proposed CBOE Rule 44.4(b)(ii). RFQ responses would be submitted to the SBT Book and would be exposed as they arrived.

j. Trading Directly Against Orders in the Book

CBOE*direct* would provide SBT Traders the means to electronically hit a bid or take an offer. An SBT Trader could do a full or partial execution of an existing bid or offer.

1. *Hit the Bid.* If the bid were no longer available for trading (*e.g.,* because the bid had been hit by another trader), the System would book the full order (*i.e.,* the order entered to hit the bid) as a day or IOC order at the discretion of the trader. If another trader had not hit the bid, the results of the trader's attempt to hit the bid would be as follows:

| Change to price field | Change to quantity field | Results |
|---|---|---|
| None | None | Full execution of bid orders at bid price. |
| None | Lower | Partial execution of bid orders at bid price. |
| None | Higher | Full execution of bid orders at bid price and book new order to sell at bid price with remaining quantity. |
| Lower | None | Full execution of bid orders at bid price. |
| Lower | Lower | Partial execution of bid orders at bid price. |
| Lower | Higher | Full execution of bid orders at the bid price and new order to sell with remaining quantity that could either execute against lower bid orders, if any, or be booked. |
| Higher | Any | No execution, book new order to sell. |

2. *Take the Offer.* If the offer were no longer available for trading (*e.g.,* because the offer had been taken by another trader), the System would book the full order (*i.e.,* the order entered to take the offer) as a day or IOC order at the discretion of the trader. If another trader had not taken the offer, the results of the trader's attempt to take the offer would be as follows:

| Change to price field | Change to quantity field | Results |
|---|---|---|
| None | None | Full execution of offer orders at offer price. |
| None | Lower | Partial execution of offer orders at offer price. |
| None | Higher | Full execution of offer orders at offer price and book new order to buy at offer price with remaining quantity. |
| Higher | None | Full execution of offer orders at offer price. |
| Higher | Lower | Partial execution of offer orders at offer price. |
| Higher | Higher | Full execution of offer orders at the offer price and new order to buy with remaining quantity that could either execute against higher offer orders, if any, or be booked. |
| Lower | Any | No execution, book new order to buy. |

3. *Hit the Debit Spread.* If the debit spread were no longer available for trading (*e.g.,* because the debit spread had been traded by another trader), the System would book the new spread order (*i.e.,* the order entered to take the offer), as a new GTC credit spread order. If debit spread were still available, the results of the trader's attempt to ''hit the debit spread'' would be as follows:

| Change to price field | Change to quantity field | Results |
|---|---|---|
| None | None | Full execution of spread order at spread price. |

| Change to price field | Change to quantity field | Results |
|---|---|---|
| None | Lower | Partial execution of spread order at spread price. |
| None | Higher | Full execution of original spread order at spread price and book new credit spread at spread price with remaining quantity. |
| Lower | None | Full execution of spread order at the original spread price. |
| Lower | Lower | Partial execution of spread order at original spread price. |
| Lower | Higher | Full execution of spread order at the original spread price and new credit spread order at the lower price with remaining quantity that could either execute against lower debit spread orders, if any, or be booked. |
| Higher | Any | No execution, book new credit new spread order at entered price. |

1. *Take the Credit Spread.* If the credit spread were no longer available for trading (*e.g.,* because the credit spread had been traded by another trader), the System would book the new spread order (*i.e.,* the order entered to trade the spread) as a GTC debit spread order. If the credit spread were still available, the results of the trader's attempt to ''take the credit spread'' would be as follows:

| Change to price field | Change to quantity field | Results |
|---|---|---|
| None | None | Full execution of spread order at spread price. |
| None | Lower | Partial execution of spread order at spread price. |
| None | Higher | Full execution of spread order at spread price and book new debit spread order at spread price with remaining quantity. |
| Higher | None | Full execution of spread order at the original spread price. |
| Higher | Lower | Partial execution of spread order at original spread price. |
| Higher | Higher | Full execution of spread order at the original spread price and new debit spread order with remaining quantity that could either execute against higher credit spread orders, if any, or be booked. |
| Lower | Any | No execution, book new debit spread order at entered price. |

k. Intermarket Price Protection

When CBOE *direct* is enabled to provide such protection, public customer orders would not be automatically executed at prices inferior to the best bid or offer on another national securities exchange, as those best prices would be identified by the System. The System would allow the SBT DPM/LMM[37] to specify its parameters for automatic step-up, perform the automatic step-up when the NBBO was away, and send orders away to the NBBO exchange. The SBT DPM/LMM could establish different parameters for different classes to which it had been assigned. CBOE has represented that it would not trade any multiply listed options on the System unless the Exchange had procedures to handle executions that occur at prices inferior to the best bid or offer on another national securities exchange, as those best prices are identified by the System.[38]

l. Market Maker Obligations and Benefits

Option classes would be assigned to SBT Market Makers in the same way they are assigned today in the open outcry system. It is possible, however, that different members would be assigned to be the SBT DPM for the same option class for different trading sessions (*i.e.,* an SBT DPM could be assigned to a particular option class in one trading session but not another). Also, the appropriate Market Performance Committee could appoint SBT LMMs on a rotating basis such that the SBT LMM assigned to a particular option class for a particular trading session would rotate between two or more SBT LMMs after a designated period of time.

Unlike in open outcry, there would not necessarily be a continuous quoting obligation; however, also unlike in open outcry, the majority of market makers logged onto the System would be required to provide their own independent quote in response to a specified percentage of RFQs. CBOE anticipates that active products would be quoted competitively and continuously by multiple market makers while inactive products would be quoted through RFQs. The appropriate Market Performance Committee would have the authority to recommend, and the board of directors of the Exchange to vary, the RFQ response rates to ensure that quality markets were available before an order executed. In addition, as stated earlier, the appropriate Market Performance Committee or two Trading Officials could exempt SBT Market Makers from the requirement to respond to RFQs and to provide opening quotes if the System were being used during a time when there was little liquidity in the underlying securities (*i.e.,* during an ETH session).

i. Market-Maker Obligations

In addition to the other market maker obligations set forth in proposed CBOE Rule 44.4, a Standard SBT Market Maker would be obligated to respond to a designated percentage of RFQs for the series in its assigned classes. The appropriate Market Performance Committee would decide the applicable percentage. In addition, an SBT DPM/LMM would be obligated, among other things, to provide opening quotes for all series in assigned classes and to respond to a certain percentage of RFQs (as

[37] In the original draft notice, CBOE discussed the handling of orders when there are better prices on away markets only with respect to SBT DPMs. CBOE has confirmed that this discussion also applies to SBT LMMs. Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Michael Gaw, Division, Commission, on November 16, 2001.

[38] The Commission notes that the proposed rule change does not address how the System (or SBT DPM/LMMs assigned to option classes on the System) would handle orders when there is a better price in another market. CBOE has advised that, initially, CBOE*direct* will be employed to trade only option classes that are not multiply listed; consequently, it does not need to address this issue at this time. CBOE has represented that, to comply with its obligations under the Linkage Plan Order, *see* Securities Exchange Act Release No. 43086, 65 FR 48023 (August 4, 2000); Securities Exchange Act Release No. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000); Securities Exchange Act Release No. 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000), it would amend the CBOE*direct* rules to address better prices on other markets prior to employing the System to trade multiply listed option classes. Telephone conversation of April 5, 2002.

determined by the appropriate Market Performance Committee) for the series in assigned classes.

*RFQ Response Rate.* For each series that an SBT Market Maker had been obligated to quote via RFQ, the System would calculate at the end of the day the market maker's RFQ response rate. The response rate would be computed as the number of times the market maker responded with an acceptable quote within a designated number of seconds (as determined by the SBT Trading Committee), divided by the number of RFQs to which the market maker was obligated to respond, expressed in percentage terms.

The appropriate Market Performance Committee would set the percentage of RFQs to which a market maker would be required to respond to ensure that a high quality of markets were available before any order was executed. CBOE anticipates that the Market Performance Committee would establish the RFQ response rate at a fairly high percentage, although it is likely to be much lower during an ETH session. To be credited toward a market maker's percentage requirement, the following requirements would have to be met: (1) The market maker must respond to the RFQ within a designated number of seconds (as established by the appropriate Market Performance Committee); (2) the quote width must be equal or narrower than the prescribed legal width market (as it may have been adjusted by the appropriate Market Performance Committee); (3) the quote size must be at least equal to the specified minimum size (established by the appropriate Market Performance Committee); and (4) the SBT Market Maker must provide a continuous market for 30 seconds, unless the SBT Market Maker's quote is filled in the meantime. The market maker could change its quote during this period but could not cancel it if the quote were to count toward the market maker's RFO percentage response requirement.

The System would send duplicate RFQs, which are RFQs for a series for which an RFQ was outstanding. Duplicate RFQs would be sent in order to give the SBT Market Maker an indication of the increasing level of interest in the product. SBT Market Makers would not be obligated to respond to each duplicate RFQ for a particular series in order to satisfy their percentage response requirement. The SBT Market Maker would be obligated to respond only once to the group of duplicate RFQs. For example, if two RFQs for a series were sent by the System within the life of the initial RFQ, there would be the first RFQ and two duplicates. The SBT Market Maker would be obligated to respond only once to all three to satisfy its percentage response requirement with respect to all three.

RFQ responses (*i.e.,* quotes) would be submitted to the SBT Book and exposed as they arrived.

The RFQ response rate would be calculated on a daily basis and cumulated over the evaluation period (weekly, monthly, or quarterly).

To avoid the unreasonable use of the RFQ process and in order to maintain reasonable loads on the System capacity, the System would monitor the ratio of RFQs to trades generated by each trader. CBOE has stated that it might impose a non-discriminatory charge per RFQ above a certain ratio.[39]

ii. Market Maker Benefits

Both Standard SBT Market Makers and SBT DPMs/LMMs could be entitled to a reduction in fees for market data regarding, for example, book depth and underlying security data. SBT DPMs/LMMs also could receive the additional benefit of a trade participation right for trades done at their quoted bid or offer.

m. Quote Entry

SBT Market Makers could enter quotes in two ways: manually or through an autoquote facility. A quote would exist as a pair of bid and ask day orders in the SBT Book. An SBT Market Maker could have only a single quote for any particular option series (*i.e.,* the System would process a new quote as a cancel/replace of the old quote). An SBT Market Maker could, however, enter other orders in the same series for which it had a quote.

The System would recognize and remember which orders were plain orders (*i.e.,* unrelated to quotes) and which orders were part of a quote. Distinguishing between quotes and orders in this manner would allow the System to monitor how SBT Market Makers were fulfilling their obligation to respond to RFQs and also would allow for quotes to be regenerated automatically as described below.

In the special case where an SBT Trader had half a quote in the market (*i.e.,* its bid or ask had been hit) and it wanted to keep the remaining side, the System would allow the market maker to update only the missing side. In the case where the market maker was updating only one side of a quote, the System would allow the market maker to enter a quote with one side updated and the other side unchanged, and update only the changed side. In these two cases, the market maker might not want to replace the bid/ask it already had in the market because that order had price/time priority.

n. Quote Maintenance

An SBT Market Maker would have the following functional capabilities for maintaining its quotes in the SBT Book: (1) Cancel a specific quote; (2) cancel all of its quotes in a specified class, or all quotes in all classes; (3) cancel/replace or update an existing quote; and (4) inactivate its quotes for a certain period of time. An update would not necessarily cause the order to lose its priority position. An order would be considered to have undergone a cancel/replace if its position had changed due to a price change or quantity increase.

Depending on how a quote was modified, the order's position could change as follows:

1. If the price were changed, the changed side would lose priority position and the order would go behind all orders at the same price.

2. If one side's quantity were changed, the unchanged side would retain priority position.

3. If the order's quantity were decreased, the order would retain position.

4. If the order's quantity were increased, the order would lose position and the order would go behind all orders at the same price.

*Cancel a Quote.* If the cancel arrived in the SBT Book after one or both sides of the quote had been partially executed, the System would cancel the remainder and return a ''too late to cancel'' message for the filled quantity.

*Inactivate All Quotes.* There is a difference between canceling quotes and inactivating quotes. ''Cancel'' would permanently delete the SBT Market Maker's quotes from the SBT Book. ''Inactivate'' would remove the SBT Market Maker's quotes temporarily from the SBT Book without deleting them. CBOE anticipates that the System ultimately would provide for such orders to be available for a specified time for ''activation'' or re-submission to the SBT Book without manual re-entry.

*Quote Risk Monitor Function.* CBOE believes that the quote risk monitor function would provide benefits to both the customers and SBT Market Makers. For the customer, CBOE expects that markets would be deeper and more liquid—with quotes of larger size and more market makers providing quotes—because market makers would have

[39] *See* Securities Exchange Act Release No. 45075 (November 16, 2001), 66 FR 59038 (November 26, 2001) (SR–CBOE–2001–57) (establishing fees for excessive RFQs). *But see* Securities Exchange Act Release No. 45231 (January 3, 2002), 67 FR 1382 (January 10, 2002) (rescinding SR–CBOE–2001–57).

better control of their risk and, therefore, would be more willing to quote aggressively. SBT Market Makers would be able to control their risk after they had traded a certain number of contracts.

CBOE has stated that SBT Market Makers that would provide quotes on the System would be exposed to certain types of risks different than those who trade in open outcry. For example, a market maker on CBOE*direct* could have a large number of its bids hit by a set of incoming orders within a few seconds if the bids were the best available or close to the best available. The market maker could, thus, be subject to taking on a large position before it could react and change its quotes. In open outcry, a market maker is often better able to manage its risk because it can change its market at the point that it believes that the orders that have been traded on one side of the market justify such a move.[40]

To encourage market makers to provide deep and liquid markets on CBOE*direct,* the quote risk monitor feature would automatically delete a market maker's quotes from a class when the System determined that its resting orders (quotes) had been filled within a defined period of time (*e.g.,* the most recent ten-second period) for a defined number of contracts. When the System deletes a market maker's quotes in a particular class, the System would notify the market maker to give it a chance to react and update its quotes.

In determining whether to delete a particular market maker's quotes pursuant to this feature, the System would consider only trades with the market maker's resting quotes, not trades that the market maker had initiate by hitting a bid or taking an offer. The function also would take effect even if the incoming orders were uncoordinated (*i.e.,* coming from one or more sources). The time period within which the trade takes place and the net contract volume would be configurable by the SBT Market Maker for each class.

*Automatic Quote Regeneration.* CBOE*direct* has been designed to allow for an SBT Market Maker's quotes to be automatically regenerated, although this feature is not yet available as part of the CBOE*direct* pilot program.[41] This feature would make certain that an SBT Market Maker could maintain continuous quotes in the System and retain priority for those quotes not traded. The SBT Market Maker would be able to request the System to regenerate its quote when its bid or offer had been filled. The System would regenerate a new quote where the bid/offer was a pre-defined number of ticks worse than the prior bid/offer that was filled, and the size for the bid/offer would be the default size that the market maker had established.

When a bid/offer is regenerated, the System would keep the opposite side at the same price unless the resulting spread would be wider than the prescribed legal width market. If the resulting spread was wider than the Exchange-prescribed width, the System would adjust the opposite side's price (*i.e.,* cancel/replace the old order) to keep the same spread before the regeneration, or adjust it to bring the spread to the legal width market. The market maker would have to make this choice as a pre-defined selection when it specifies its defaults for quote regeneration.

Except under one circumstance, the System would position the regenerated quote based on price/time priority. This exception would provide for the regenerated quote to move ahead of other orders in priority position. If the regenerated quote (order) could immediately execute against the same order that traded against the original quote, that portion of the regenerated quote (order) equal to the original size executed would go ahead of all orders at the regenerated price and would be executed. The System would position the rest of the regenerated quote based on price/time priority.

*Example.* Assume the System receives a market order for 20 contracts that is traded against a quote for 5 contracts at a bid of 5.50. The market order still has 15 contracts left to be filled. There are no other resting orders at the execution price. The regenerated bid for 10 (*i.e.,* the default quote size for the market maker who had bid at 5.50) is at the next lower price, 5.45 with other standing orders. The portion of the regenerated bid that is equal to the original execution size (*i.e.,* 5) is placed ahead of all orders at the regenerated price and receives first execution priority. The remaining portion of the regenerated bid (*i.e.,* 5) is positioned behind all other resting orders at 5.45.[42]

*Managing Autoquote Traffic.* Proposed CBOE Rule 44.6 would provide that the Exchange may limit the number of market makers that may access CBOE*direct* through an API, or the number of messages sent by market makers accessing the System through an API, in order to protect the integrity of the System. In addition, CBOE has proposed to be able to impose restrictions on the use of a computer connected through an API if it believed such restrictions were necessary to ensure the proper performance of the System. CBOE has represented that these proposed restrictions are not intended to permit the Exchange to discriminate against certain traders but would be used pursuant to some objective measure to limit the messages sent through the API, if necessary.

CBOE does not intend to allocate bandwidth to each SBT Trader (*i.e.*, the System would not programmatically limit the number of messages that a trader may send). To minimize the potential of a particular SBT Trader from unnecessarily burdening the System, CBOE has proposed to be able to do one or both of the following: (1) Specify the number of quotes over a certain time period that may be sent free by an SBT Trader, or (2) impose a fee per message for sending a number that is clearly above the free number and for producing a ratio of quotes to trades over a certain time period that is higher than what would be considered a reasonable ratio.[43] For example, assume that the free number is 4,000 quotes per class per day and the reasonable ratio of quotes to trades is 50:1. A fee might be assessed such that an SBT Market Maker is charged for every quote above 4,000 if the ratio is between 56:1 and 65:1, and two pennies per message if the ratio is between 66:1 and 75:1, *etc.* CBOE believes that this fee would provide an incentive to market makers to provide aggressive and narrow quotes that are likely to trade against orders sent to the System. This fee would, therefore, supplement the market maker quote obligations by providing for market makers not only to provide quotes but also to ensure their quotes are reasonably likely to trade.

CBOE also may implement a message throttle in the API to further limit the potential harm to the System from quote traffic. CBOE has represented that any measures used to throttle quotes or to limit quotes would be objective

[40] CBOE has noted that, to the extent there is an automatic execution system (*e.g.,* RAES) that is available in the open outcry market, the market makers logged onto the automatic execution system are subject to the same kind of risks as market makers on an SBT System.

[41] E-mail from Angelo Evangelou, Legal Division, CBOE, to Michael Gaw, Division, Commission, dated April 25, 2002.

[42] This example has been corrected slightly from the example provided in Exhibit 1 of Amendment No. 1 to reflect decimalized rather than fractional prices. E-mail from Angelo Evangelou, Legal Division, CBOE, to Michael Gaw, Division, Commission, dated November 16, 2001.

[43] The Commission notes that any proposed rule change relating to fees must be filed with the Commission pursuant to Section 19(b) of the Act, 15 U.S.C. 78s(b). After such a filing has been made, the Commission would consider whether the proposed fee was consistent with the Act.

measures imposed in a non-discriminatory manner.

o. Order Entry

All SBT Traders, including SBT Market Makers, would be able to enter orders for any class. These orders would be plain orders, handled differently by the System from orders that are part of market maker quotes.

*Order Status and Maintenance.* An SBT Market Maker would have the capability to display the status of its active orders (submitted to the SBT Book), both regular and quote-related orders. It also would have the capability to keep orders in the System that were inactive (*i.e.*, not in the SBT Book). An SBT Market Maker could inactivate some or all of its quotes but keep them in the System so it could activate them again when it wanted to get back into the market.

*Spread Order Entry.* Any SBT Trader would have the capability to enter spread orders. The System would support spread orders whose legs were options of the same underlying security. The System would provide support for the most common, two-legged spread orders: vertical, combo, straddle, and time. The System also would allow a market maker to enter a customized spread order with more than two legs. The System would calculate and display the current bid and offer for the spread with a net credit or debit indication, if a market were available for each leg.

p. SBT Brokers

An SBT Broker would be an individual (either a member or a nominee of a member organization) who was registered with the Exchange for the purpose of accepting and executing orders received from members, registered broker-dealers, or public customers on CBOE*direct.* As with brokers operating in the Exchange's auction market, an SBT Broker would not be permitted to accept an order from any source other than a member or a registered broker-dealer, unless it were either the nominee of, or had registered its individual membership for, a member organization approved to transact business with the public in accordance with CBOE Rule 9.1.

SBT Brokers would have the same obligations as brokers on the Exchange's auction market to use due diligence in the representation of orders for which they were agent. SBT Brokers and Proprietary Traders could use the SBT workstations or API to perform the following functions:

- Enter, cancel, cancel/replace, and maintain orders;
- Hit bids and take offers;
- Submit RFQs;
- Enter cross notifications and cross execution orders; and
- Set up defaults or preferences.

The Exchange could provide other means for the submission of orders or other functions other than through the use of the SBT workstations or API.

q. Clearing Firm Brokers

Proposed CBOE Rule 45.11 would govern the functions of Clearing Firm Brokers. A Clearing Firm Broker would be an individual who represented the Clearing Firm of a particular SBT Market Maker and had the authority to take certain actions with respect to that SBT Market Maker's use of the SBT System.

A Clearing Firm Broker could request the CBOE Help Desk to force the logout of a trader when, for example, that trader had financial difficulty. The forced logout of a trader also could be necessary when the trader is having technical difficulties that prevent the trader from logging off on his or her own. The System would provide two options for logging out an SBT Trader: (1) Force logout, and (2) force logout and disable. ''Force logout'' would log out the trader, cancel all of the trader's quotes, leave the trader's regular orders unchanged, and would not affect the trader's ability to log in. This option would be used for situations where the trader could not log out on his or her own for any reason. ''Force logout and disable'' would log out the trader, cancel all of the trader's quotes, cancel all the trader's regular orders, and de-authorize the trader as a user. The Help Desk would have to re-enable the trader before he or she could log in again under this second option. In this case, the Clearing Firm could have another trader trade the logged out trader's account for some period of time to manage the positions.

r. Data Dissemination

*Internal Dissemination of Quote and Best Bid and Offer.* CBOE*direct* would disseminate the best bid and offer internally. As each new limit order (whether as an order or as part of a market maker quote) was entered into the SBT System, the best bid and offer displayed in the System would be updated to the extent the new bid or offer changed the previously displayed bid or offer. The System would send quote/order information—series, price, size, and order source (market maker, customer, or non-customer professional order)—to the SBT workstations that were trading a given class. The System also would provide the current best bid or offer in any other market as such best bids and offers were identified in the System.

*Internal Dissemination of Price/Last Sale.* CBOE*direct* would disseminate internally to SBT Market Makers appointed to a given class, and to all subscribers' workstations that have indicated interest in a given class, last sale information including series, price, and size.

*Booked Order Dissemination.* When an SBT Trader or subscriber requests market data for an option class, CBOEdirect would provide the SBT Book's best bids, asks, and their total volumes for each series of the class requested. The data also would include the last sale, day's trade volume, and the SBT Trader's orders for each series. CBOE could delete or add information to the market data disseminated as it deemed appropriate. The market data would be accessible to any SBT Trader, although the Exchange could charge varying fees to different categories of traders for access to the information.

*Book Depth Data.* Upon request, traders could access from the System market depth information, including the aggregate size and the number of contracts at each price. CBOE could charge fees for access to this information. The information might not be provided upon request if the Exchange believed that it could lead to degradation of the System.

*Dissemination to OPRA.* CBOE*direct* would disseminate quote and trader (*i.e.,* last sale) information externally to OPRA and/or to some other distribution network to the extent permitted by agreement or by rule. Series, price, and size would be disseminated for trades. Series and price would be disseminated for quotes. Quote size also would be disseminated if OPRA were capable of accepting quotes with size. Every best book bid/ask change would generate a quote report to OPRA and/or some other network. The CBOEdirect quote might not have a bid/ask spread that was equal to or narrower than the Exchange-prescribed spread because two unrelated orders, separated by more than the Exchange-prescribed spread, might be the best orders, causing the System to send their prices as the best quote. Changes in best quote and size due to AON or FOK contingency orders would not update quotes in OPRA. CBOE has stated that it would notify recipients that information sent over the System to SBT workstations would be considered proprietary information of the Exchange and could not be distributed or shared without written permission of the Exchange.

2. Statutory Basis

CBOE believes the proposed rule change would provide for a fair and innovative electronic medium for the trading of securities options that will be registered by the established procedures and personnel of the Exchange. Accordingly, CBOE believes that the proposed rule change is consistent with Section 6(b) of the Act [44] in general, and furthers the objectives of Section 6(b)(5) [45] in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest.

*B. Self-Regulatory Organization's Statement on Burden on Competition*

CBOE does not believe that the proposed rule change would impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

*C. Self-Regulation Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

No written comments were solicited or received with respect to the proposed rule change.

[44] 15 U.S.C. 78f(b).

[45] 15 U.S.C. 78f(b)(5).

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** or with such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change; or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. In particular, the Commission requests commenters to address the proposed trade nullification procedures, crossing procedures, and allocation methodologies, especially the proposal that customer orders may not necessarily be accorded the highest priority. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filings will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR–CBOE–00–55 and should be submitted by May 29, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[46]

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02–11098 Filed 5–7–02; 8:45 am]

**BILLING CODE 8010–01–P**

[46] 17 CFR 200.30–3(a)(12).