

multiple SBT market makers would continuously quote actively traded products, while less actively traded products would be quoted through the RFQ process.<sup>18</sup> The Exchange indicated, however, that when the SBT System is used during an extended trading hour ("ETH") session, most products likely would be quoted through RFQs.<sup>19</sup>

## B. Market Participants

### 1. Market Makers

An SBT market maker is a CBOE member who is either an SBT standard market maker, an SBT designated primary market maker ("DPM"), or an SBT lead market maker ("LMM"). An applicant for registration as an SBT market maker must file an application with the Exchange's Membership Department; the Exchange's Membership Committee may approve or disapprove the applicant's registration as an SBT market maker.<sup>20</sup> A registered SBT market maker may apply for an appointment in one or more classes of option contracts traded on CBOE*direct*. 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 or make additional appointments whenever, in the Committee's judgment, the interests of a fair and orderly market would best be served by such action.<sup>21</sup>

With respect to each class of options for which it holds an appointment, an SBT market maker has a continuous obligation to engage, to a reasonable degree under the existing circumstances, in dealings for its own account when there exists or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular option contract, or a temporary distortion of the price relationships between option contracts of the same class. An SBT market maker is expected to perform the

following activities in the course of maintaining a fair and orderly market:

- Competing with other SBT market makers to improve markets in all series of options class in which the SBT market maker holds an appointment;
- Making markets which, absent changed market conditions, will be honored for the number of contracts entered into the SBT System in all series of options classes in which the SBT market maker holds an appointment; and
- Updating market quotations in response to changed market conditions in all series of options classes in which the SBT market maker holds an appointment.<sup>22</sup>

In addition, at least 75% of an SBT market maker's total contract volume on CBOE*direct* must be in options classes in which it holds an appointment.<sup>23</sup>

Furthermore, SBT market makers are required to respond to a certain percentage of RFQs that they receive. The appropriate Market Performance Committee has the authority to determine the percentage of RFQs to which an SBT standard market maker would be required to respond, which percentage may not be less than 75%,<sup>24</sup> and may vary the RFQ response rate on a series-by-series basis.<sup>25</sup> SBT DPMs and LMMs are subject to higher requirements and must respond to 98% of the RFQs that they receive.<sup>26</sup> An SBT market maker would be credited for an RFQ response only if: (1) The SBT market maker responds to the RFQ with a two-sided market within a number of seconds designated by the appropriate Market Performance Committee; (2) the quote width is equal to or narrower than a legal width market; <sup>27</sup> (3) the quote size is at least equal to the minimum size specified by the appropriate Market Performance Committee and in any case

is at least five contracts; and (4) the SBT market maker provides a continuous market for 30 seconds, or the quote is filled before the 30-second period expires.<sup>28</sup> The SBT market maker could change its quote during this period but could not cancel it to receive credit for the response.<sup>29</sup>

On CBOE*direct*, a market maker may also be a designated primary market maker ("DPM") or a lead market maker ("LMM"). The Exchange's SBT DPM Committee may assign an SBT DPM to a particular option class.<sup>30</sup> Different members could be assigned to be the SBT DPM for the same option class during different trading sessions.<sup>31</sup> If the SBT DPM Committee does not appoint an SBT DPM in a given class, the appropriate Market Performance Committee could appoint one or more SBT LMMs.<sup>32</sup> If more than one SBT LMM is appointed, they would function as the SBT LMM on a rotating basis in accordance with a schedule set by the appropriate Market Performance Committee.<sup>33</sup> SBT LMMs would have responsibilities similar to SBT DPMs.<sup>34</sup>

The obligations of SBT DPMs and LMMs are greater than those of SBT standard market makers.<sup>35</sup> SBT DPMs and LMMs are obligated, for example, to provide opening quotes for all series in their allocated classes.<sup>36</sup> The appropriate Market Performance Committee also could require that an SBT DPM or LMM provide continuous quotations in some or all of the series of its appointed classes.<sup>37</sup> Furthermore, SBT DPMs and LMMs are required to handle public customer orders that are not executed on the System due to the fact that there is a better quote on another exchange, and to accord priority to such public customer orders over their own principal transactions (unless the customer who placed the order has consented to not being accorded such priority).<sup>38</sup>

### 2. Brokers

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 on CBOE*direct* orders

<sup>22</sup> See CBOE rule 44.4(a)(1). In Amendment No. 4, the Exchange clarified SBT market makers' obligations by incorporating into CBOE rule 44.4(a)(1) the provisions of its existing CBOE rule 8.7 (setting forth market makers' obligations on the Exchange floor), modified to take into account differences between making markets on a physical floor and on an electronic platform.

<sup>23</sup> See CBOE rule 44.4(a)(2).

<sup>24</sup> See CBOE rule 44.4(b). The response rate would be computed as the number of times the SBT market maker made a credited response, divided by the number of RFQs to which the market maker was obligated to respond. See notice, *supra* note 4, 67 FR at 31039. In addition, the appropriate Market Performance Committee could, depending on the liquidity in any of the underlying markets during an ETH session, determine not to impose an RFQ response requirement, or impose an RFQ response rate lesser than the one applicable during regular trading hours. See CBOE rule 44.4(d).

<sup>25</sup> See CBOE rule 44.4(e).

<sup>26</sup> See CBOE rules 44.4, Interpretation .01(a)(4) and 44.14(a)(4).

<sup>27</sup> See *supra* note 13.

<sup>28</sup> See CBOE rule 44.4(b).

<sup>29</sup> See *id.*

<sup>30</sup> See CBOE rule 44.12.

<sup>31</sup> See CBOE rule 44.16.

<sup>32</sup> See CBOE rule 44.3, Interpretation .01.

<sup>33</sup> See *id.*

<sup>34</sup> See CBOE rule 44.4, Interpretation .01(a).

<sup>35</sup> See CBOE rule 41.1(a)(2).

<sup>36</sup> See CBOE rules 44.4, Interpretation .01(a)(2) and 44.14(a)(2).

<sup>37</sup> See *id.*

<sup>38</sup> See CBOE rules 44.14(b)(6) and 44.4, Interpretation .01(a)(6).

<sup>18</sup> See notice, *supra* note 4, 67 FR at 31038.

<sup>19</sup> In addition, the appropriate SBT Trading Committee may determine to limit the kinds of orders that may be traded during an ETH session, even if such order types may be traded during an RTH session. See CBOE rule 43.2(b). CBOE has represented that it would distribute an information circular indicating any committee determination to limit the order types that may be traded during an ETH session. Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Elizabeth King, Division of Market Regulation, Commission, on June 21, 2002 ("June 21 conversation").

<sup>20</sup> See CBOE rule 44.2(a).

<sup>21</sup> See CBOE rule 44.3(a).