

received from members, registered broker-dealers, or public customers. As with brokers operating in the Exchange's open-outcry 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 he or she were approved to transact business with the public in accordance with CBOE rule 9.1.<sup>39</sup>

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 act as agent. SBT brokers may use an SBT workstation or an API to enter, cancel, cancel/replace, and maintain orders; hit bids and take offers; submit RFQs; and enter cross notifications and proposed cross orders.

### 3. Proprietary Traders

A proprietary trader is a CBOE member who enters orders as principal for a non-market-maker proprietary account.<sup>40</sup> A proprietary trader may use an SBT workstation or an API to enter, cancel, cancel/replace, and maintain orders; hit bids and take offers; and submit RFQs.

### 4. Clearing Firm Brokers

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 market maker's use of the SBT System.<sup>41</sup> A clearing firm broker may request the CBOE Help Desk to force the logout of an SBT trader when, for example, that trader has financial difficulty. In addition, the forced logout of an SBT trader could be necessary if technical difficulties prevented the trader from logging off on his or her own.

### C. Priority

The proposed CBOEdirect rules do not prescribe a single allocation methodology. Instead, the rules give the appropriate SBT Trading Committee authority to apply various allocation priorities. CBOE has represented that it would issue a regulatory circular specifying the allocation rules that would govern each option class.<sup>42</sup>

There would be two basic types of trade allocation methodologies:

- **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 sequence in which they were received by the System.<sup>43</sup>

- **Pro Rata Priority.**<sup>44</sup> Under this method, 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 their size.<sup>45</sup> The executable quantity would be allocated to the nearest whole number, with fractions one-half or greater rounded up and fractions less than one-half rounded down.<sup>46</sup>

In addition to these allocation methodologies, the appropriate SBT Trading Committee could determine to overlay, on a class-by-class basis and in any order, any or all of the following additional market participant priorities ("priority overlays"):<sup>47</sup>

1. **Public Customer.** If this were the only priority overlay 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 option series at the same price, priority would be afforded to these orders in the sequence in which they had been received by the System, even if the *pro rata* allocation method were the designated allocation method. For purposes of this provision, a "public customer order" is an order for an account in which no CBOE member, non-member participant in a joint venture with a member, or non-member broker-dealer (including a foreign broker-dealer) has an interest.<sup>48</sup>
2. **Market Turner.** The "market turner" is the SBT trader who is the first to enter an order or quote at a better price than the previous best book price, and the order or quote was continuously in the market until it traded.<sup>49</sup> If market turner priority were the only priority

overlay 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, 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 market 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.** SBT DPMs and LMMs may be granted a trade participation right to trade against up to 40% of an incoming order,<sup>50</sup> even though the order and/or quote of the SBT DPM or LMM do not have the highest priority. If other priority overlays were also in effect, priority would be established in the sequence designated by the appropriate SBT Trading Committee. All of the following conditions would apply to the SBT DPM or LMM trade participation right:

- The order and/or quote of the SBT DPM or LMM must be at the best price.<sup>51</sup>
- An SBT DPM or LMM may not be allocated a total quantity greater than the quantity than it was quoting at that price.<sup>52</sup>
- If *pro rata* priority is in effect and the SBT DPM's or LMM's allocation of an order pursuant to its trade participation right is greater than its percentage share of the quotes/orders at the best price at the time that the trade participation right is granted, the SBT DPM or LMM may not receive any further allocation of that order.<sup>53</sup>
- If the trade participation right priority overlay and the market turner priority overlay are both in effect and the SBT DPM or LMM were the market turner, market turner priority would not apply.<sup>54</sup>

<sup>39</sup> See CBOE rule 43.1(a)(1). For examples of how the price-time allocation method would operate, see notice, *supra* note 4, 67 FR at 31027-28.

<sup>40</sup> In Amendment No. 4, CBOE changed the name of this allocation methodology from "combined price-time and size priority" to "*pro rata* priority."

<sup>41</sup> See CBOE rule 43.1(a)(2). For examples of how this allocation method would operate, see notice, *supra* note 4, 67 FR at 31028-31.

<sup>42</sup> If there were two SBT traders that were both entitled to an additional one-half contract and there were only one contract remaining to be distributed, the additional contract would be distributed to the SBT trader whose quote or order had time priority. See CBOE rule 43.1(a)(2).

<sup>43</sup> See CBOE rule 43.1(b).

<sup>44</sup> See CBOE rule 43.1(b)(1).

<sup>45</sup> See CBOE rule 43.1(b)(1).

<sup>46</sup> See CBOE rule 40.1(i).

<sup>50</sup> See CBOE rules 43.1(b); 44.4, Interpretation .01(b); and 44.15. However, the participation of an SBT DPM or LMM in an order may exceed 40%, depending on the allocation rules in effect. See *id.* Assume, for example, that price-time priority is in effect. An SBT DPM or LMM could receive up to 40% of an incoming order due to its trade participation right, then receive an additional portion of the incoming order if it has an order or quote on the SBT book that has the highest time priority at the best price. If *pro rata* priority were in effect, an SBT DPM or LMM could receive up to 40% of an incoming order due to its trade participation right, then receive an additional portion of the incoming order if its percentage of the total volume being quoted at the best price exceeds 40%.

<sup>51</sup> See CBOE rule 43.1(b)(3)(A).

<sup>52</sup> See CBOE rule 43.1(b)(3)(B).

<sup>53</sup> See *id.*

<sup>54</sup> See CBOE rule 43.1(b)(3)(C).

<sup>39</sup> See CBOE rules 41.1(a)(5) and 45.1.

<sup>40</sup> See CBOE rule 41.1(a)(6).

<sup>41</sup> See CBOE rule 45.11.

<sup>42</sup> See notice, *supra* note 4, 67 FR at 31026.