

## 1. Interim Crossing Procedure

Under CBOE *direct's* interim crossing procedure, an SBT broker that wishes to cross two original orders of at least 50 contracts or to facilitate an original order of at least 50 contracts must first send an RFQ with the size of the orders to be crossed.<sup>137</sup> The RFQ response period will be established by the SBT Trading Committee and will not be less than ten seconds.<sup>138</sup>

Within a time period after the RFQ response period has expired (such time period to be established by the SBT Trading Committee and not to exceed ten seconds<sup>139</sup>, the SBT broker must expose one of the orders to the SBT book.<sup>140</sup> If the exposed order is not completely taken out by other SBT traders by the end of the exposure period, the SBT broker could enter the opposite order to cross the balance of the exposed order.<sup>141</sup>

## 2. Permanent Crossing Mechanism

In the future, CBOE *direct* will provide for a participation right for SBT brokers who wish to cross orders. As with the interim procedure, an SBT broker first would have to submit an RFQ for a size equal to the quantity to be crossed.<sup>142</sup> The SBT market makers receiving the RFQ would have a response period for a length of time (such time period to be established by the SBT Trading Committee, but no less than ten seconds<sup>143</sup> to enter orders or quotes that matched or improved upon the existing quotations on the System.<sup>144</sup> Within a time period after the RFQ response period expires (such time period to be established by the SBT Trading Committee and which may be no longer than 20 seconds<sup>145</sup>), the SBT broker

would enter the terms of the proposed cross transaction.<sup>146</sup> 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 a designation of which order (in the case of a cross of two customer orders) is to be exposed to the market after the SBT broker received the guaranteed crossing percentage.<sup>147</sup> The customer order would be the exposed order in a facilitation cross.<sup>148</sup>

At the time the cross transaction is entered on the System:

- A legal width market would have to exist for the particular series to be crossed; and
- The proposed cross price would have to be between the best bid and offer displayed by the System.<sup>149</sup>

After accepting the cross transaction, the System would immediately cross 40% of the two orders. The System would expose in the SBT book the contracts remaining in the designated order for a period of ten seconds. The order's price and the remaining quantity would be disclosed but there would be no indication that the order was part of an impending cross. The System would place the opposite order on hold as a shadow order that would not be visible except to the submitter.<sup>150</sup> As long as the exposed order is the highest priority order at the best price, other SBT traders could trade against it during the ten-second exposure period.<sup>151</sup>

If, at the end of the ten-second exposure period the order has not yet been fully traded, and the exposed order is at the best price and has the highest priority, the System would execute the remainder of the order against the shadow order.<sup>152</sup> If, however, the exposed order is not the highest priority order at the market, the System automatically would cancel the remainder of the exposed order and the shadow order and send the SBT broker a message that the crossing transaction is completed. If the exposed order has a quantity remaining after the crossing transaction is completed and is the

highest priority order at the market, it would remain in the SBT book.

## 3. Interpretation Relating to Crossing Procedure

The availability of the crossing mechanism would not alter a member's best execution duty to obtain the best price for its customer. Moreover, CBOE proposes to make it explicit in its rules that it would be a violation of an Exchange member's duty of best execution to its customer if it were to cancel or withhold a customer order to avoid execution of the order at a better price.<sup>153</sup> Accordingly, if a member were to cancel or withhold a customer order when there was a superior price available on the System, and subsequently enter the order at an inferior price after the better price were no longer available without attempting to obtain that better price for its customer, there would be a presumption that the member did so to avoid execution of the customer order in whole or in part at the better price.<sup>154</sup>

### I. Additional System Functionality

#### 1. Entry and Maintenance of Orders and Quotes

All SBT traders, including SBT market makers, may enter orders into the System for any option class. However, only SBT market makers may enter quotes. An SBT market maker may have only a single quote for any particular option series but may enter multiple orders in the same series, regardless of whether it has a quote in that series displayed on the System. However, the SBT System would distinguish between an SBT market maker's quotes and orders and credit only the quotes towards the market maker's quoting obligations.<sup>155</sup>

An SBT market maker may enter a quote in one of two ways: manually or through an autoquote facility.<sup>156</sup> Unlike in the open-outcry system, the Exchange will not provide an autoquote facility to SBT market makers. However, SBT market makers may use their proprietary autoquote systems to submit quotes through the API.

CBOE rules 43.12, 43.12A, and 43.12B for an SBT broker to be a party to any arrangement designed to circumvent CBOE rule 43.12A or rule 43.12B by providing an opportunity for a customer, member, or non-member broker-dealer to execute against agency orders handled by the SBT broker immediately upon their entry into the System.

<sup>137</sup> See CBOE rule 43.12B(a).

<sup>138</sup> See *id.* CBOE has represented that it would announce the length of the response period set by the committee in an information circular. December 5 conversation.

<sup>139</sup> CBOE has represented that it would announce the length of the exposure period set by the committee in an information circular. December 5 conversation.

<sup>140</sup> See proposed CBOE rule 43.12B(b).

<sup>141</sup> See CBOE rule 43.12B(c).

<sup>142</sup> See CBOE rule 43.12A(a)(1).

<sup>143</sup> CBOE has represented that it would issue an information circular to publicize the time period established by the appropriate SBT Trading Committee. June 21 conversation.

<sup>144</sup> See CBOE rule 43.12A(a)(2).

<sup>145</sup> CBOE has represented that it would issue an information circular to publicize the time period established by the appropriate SBT Trading Committee. June 21 conversation.

<sup>146</sup> See CBOE rule 43.12A(a)(3).

<sup>147</sup> See *id.*

<sup>148</sup> See *id.*

<sup>149</sup> See CBOE rule 43.12A(a)(4). An SBT DPM or LMM would not be entitled to receive its participation right because a crossing transaction would occur at a price between the best bid and offer previously established. See CBOE rule 44.15(b).

<sup>150</sup> See CBOE rule 43.12A(a)(5).

<sup>151</sup> See CBOE rule 43.12A(a)(6).

<sup>152</sup> See CBOE rule 43.12A(a)(7).

<sup>153</sup> See CBOE rule 43.12A, Interpretation .01.

<sup>154</sup> See *id.*

<sup>155</sup> However, an SBT market maker would receive credit for an RFQ response only by submitting a quote and not two unrelated orders. Telephone conversation between Angelo Evangelou, Legal Division, CBOE, and Nancy Sanow and Michael Gaw, Division of Market Regulation, Commission, on September 30, 2002.

<sup>156</sup> See notice, *supra* note 4, 67 FR at 31039.