CBOE EXECUTE SUCCESS℠

Regulatory Circular RG16-064

Date: March 30, 2016

To: Trading Permit Holders
From: Regulatory Division
RE: Professional Orders

Updates CBOE Regulatory Circulars RG09-123 and RG09-148

On March 25, 2016, the Securities and Exchange Commission ("SEC" or "Commission") approved Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") rule filing SR-CBOE-2016-005, which adopts new Interpretation and Policy .01 to Rule 1.1(ggg) (Professional) relating to the counting of customer orders for Professional designation purposes.[1] This Regulatory Circular updates the set of Frequently Asked Questions ("FAQs") previously issued by the Exchange regarding Professional orders to reflect the rule change and provides further clarification as to how customer orders should be counted for purposes of the Exchange's Professional rule.

Professional Order Designation:

Professional Defined: The Commission's approval of SR-CBOE-2016-005 does not change the definition of the term "Professional" in the Rules. Under Rule 1.1(ggg), the term "Professional" means any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). A Professional will be treated in the same manner as a broker or dealer in securities for purposes of Rules 6.2A, 6.2B, 6.8C, 6.9, 6.13A, 6.13B, 6.25, 6.45, 6.45A (except for Interpretation and Policy .02), 6.45B (except for Interpretation and Policy .02), 6.53C(c)(ii), 6.53C(d)(v), subparagraphs (b) and (c) under Interpretation and Policy .06 to Rule 6.53C, 6.74 (except Professional orders may be considered public customer orders subject to facilitation under paragraphs (b) and (d)), 6.74A, 6.74B, 8.13, 8.15B, 8.87, 24.19, 43.1, 44.4 and 44.14. The Professional designation is not available in Hybrid 3.0 classes (currently symbol SPX only).

Counting of Orders for Professional Designation Purposes: As adopted pursuant to SR-CBOE-2016-005, Interpretation and Policy .01 to Rule 1.1(ggg) sets forth how orders should be counted for Professional designation purposes. Non-broker-dealer customers that place more than 390 orders (across all exchanges) per day on average during a calendar month as determined under the counting rules in Interpretation and Policy .01 to Rule 1.1(ggg) will be designated as Professionals. With respect to the tallying of complex orders, parent/child orders, and cancel/replace orders, the following rules apply:

(a) Complex Orders:

(1) A complex order comprised of eight (8) legs or fewer counts as a single order;

(2) A complex order comprised of nine (9) legs or more counts as multiple orders with each option leg counting as its own separate order.

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[1] See Securities Exchange Act Release No. 34-77450 (March 25, 2016) (Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend Interpretation and Policy .01 to Rule 1.1(ggg) Relating to the Professional Customer Definition) (SR-CBOE-2016-005).

(b) “Parent”/“Child” Orders:

(1) Same Side and Same Series: A “parent” order that is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple “child” orders on the same side (buy/sell) and series as the “parent” order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, counts as one order even if the “child” orders are routed across multiple exchanges.

(2) Both Sides and/or Multiple Series: A “parent” order (including a strategy order) that is broken into multiple “child” orders on both sides (buy/sell) of a series and/or multiple series counts as multiple orders, with each “child” order counting as a new and separate order.

(c) Cancel/Replace:

(1) Except as provided in paragraph (c)(2) below, any order that cancels and replaces an existing order counts as a separate order (or multiple new orders in the case of a complex order comprised of nine (9) legs or more).

(2) Same Side and Same Series: An order that cancels and replaces any “child” order resulting from a “parent” order that is placed for the beneficial account(s) of a person or entity that is not a broker, or dealer in securities that is broken into multiple “child” orders on the same side (buy/sell) and series as the “parent” order by a broker or dealer, by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer, but which is housed with the customer, does not count as a new order.

(3) Both Sides and/or Multiple Series: An order that cancels and replaces any “child” order resulting from a “parent” order (including a strategy order) that generates “child” orders on both sides (buy/sell) of a series and/or in multiple series counts as a new order.

(4) Pegged Orders: Notwithstanding the provisions of paragraph (c)(2) above, an order that cancels and replaces any “child” order resulting from a “parent” order being “pegged” to the BBO or NBBO or that cancels and replaces any “child” order pursuant to an algorithm that uses BBO or NBBO in the calculation of “child” orders and attempts to move with or follow the BBO or NBBO of a series counts as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO.

Representing Professional Orders on the Exchange: In order to properly represent orders entered on CBOE, TPHs are required to mark orders using the order origin code “W” to indicate “Professional” customer orders.[2] To comply with this requirement, TPHs are required to review their customers’ activity to determine whether non-broker-dealer orders should be represented as customer orders using order origin code “C” or as Professional orders using order origin code “W”. For TPHs that domicile customer accounts and act as agent for those accounts, the Exchange’s rules require that they take steps to track, identify, and mark orders from customers that qualify as “Professional” customers under CBOE Rule 1.1 (ggg). Under Rule 1.1(ggg):

- TPHs are required to conduct reviews of customers’ activity on at least a quarterly basis and make any appropriate changes to the way in which they are representing orders within five calendar days after the end of each calendar quarter.

- While TPHs only are required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as public customer orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the

[2] The W order origin code is also used to indicate Voluntary Professional orders. See CBOE Rule 1.1(fff).

TPH and the TPH will be required to change the manner in which it is representing the customer's orders within five days.

In general, the Professional rule does not require any action on behalf of TPHs that do not act as agent for public customer accounts. Additionally, TPHs - such as Floor Brokers - who may act as agent for public customer accounts, but do not domicile the accounts, are not expected to undertake any action to track and identify Professional orders under Rule 1.1(ggg). All TPHs, however, are required to mark orders Professional if informed that the orders are for the account of a Professional.

Additional Information:

Answers to some frequently asked questions regarding Professional orders are included below. For additional information regarding the counting of orders for Professional designation purposes, please refer to CBOE Rule Filing SR-CBOE-2016-005.[3] Questions regarding Rule 1.1(ggg) and its application may be directed to the CBOE Regulatory Interpretations and Guidance team at RegInterps@cboe.com or (312) 786-8141.

[3] See note 1 supra.

Frequently Asked Questions (FAQs)

- **Definition of Professional**

Question 1: Does the Commission's approval of SR-CBOE-2016-005 change the definition of the term "Professional" under the Exchange's rules?

> *Answer*: No. The Commission's approval of SR-CBOE-2016-005 does not change the definition of the term "Professional" in the Rules, it changes the way in which orders must be counted for purposes of the Rule.

- **Fees**

Question 2: Do transaction fees apply to Professional orders?

> *Answer*: Transaction fees may apply to Professional orders. Please see the CBOE Fees Schedule for information, available at http://www.cboe.com/publish/feeschedule/CBOEFeeSchedule.pdf.

Question 3: Is a marketing fee collected on Professional orders?

> *Answer*: No. Executions of Professional orders do not generate a marketing fee collection in the event that they trade against a Market-Maker quote. Professional orders are treated in the same manner as broker-dealer orders with respect to marketing fees.

Question 4: Can a TPH designate a Preferred Market-Maker for Professional orders?

> *Answer*: Yes. TPHs may designate a Preferred Market-Maker for Professional orders in accordance with Rule 8.13.

- **Professionals on the Exchange**

Question 5: Can Professionals place orders on both sides of the market?

> *Answer*: Yes. Rule 1.1(ggg) provides that Professionals will be treated in the same manner as broker-dealers for purposes of Rule 6.8C. Under CBOE Rule 6.8C, Prohibition Against Members Functioning as Market-Makers, TPHs may neither enter nor permit the entry of customer orders into the Exchange's electronic Order Routing System if (i) the orders are limit orders for the account or accounts of the same beneficial owner(s) and (ii) the limit orders are entered in such a manner that the beneficial owner(s) effectively is operating as a market maker by holding itself out as willing to buy and sell such securities on a regular or continuous basis. Since Professionals are treated the same as broker-dealers for purposes of Rule 6.8C, their orders are considered to be broker-dealer orders, not customer orders under Rule 6.8C and thus, the restriction does not apply to Professional orders.

Question 6: How is a Professional order identified on CBOE?

> Answer: TPHs need to identify each Professional order using "W" in the order origin field (tag47 for FIX, ORIGIN field in the message struct for CMI). Firms are advised not to send data in the Account field (tag1 for FIX; ACCOUNT field in the message struct for CMI) for orders with a "W" designation. Testing of message/order formats may be scheduled with the API Group at 312-786-7300 or api@cboe.com.

Question 7: Can TPHs test order origin coding with CBOE?

Answer: Yes. Please contact the API Group at (312) 786-7300 or api@cboe.com to coordinate testing.

- **Counting of Orders**

Question 8: Does the 390 average daily order requirement only apply to orders entered on CBOE?

Answer: No. In determining the average daily number of orders, all orders entered for the same beneficial account(s) of a non-broker-dealer customer should be considered without regard to the options exchange where the order is routed.

Question 9: Does the stock-leg of a stock-option order count as a leg of a complex order for purposes of the Professional rule?

Answer: No. Rule 1.1(ggg) defines Professional to mean a person or entity that is not a broker or dealer in securities and places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Because the stock leg of a stock option order is not an "order in listed options," it does not count towards the 390 daily average orders threshold. Accordingly, a nine-legged stock-option order with eight legs in series of listed options coupled with an order to buy or sell units of the underlying stock may be counted as a single order.

Question 10: Do Leg Orders as defined in Rule 6.53C(c)(iv) count as multiple separate orders if they are generated from a complex order that would otherwise count as one order?

Answer: No. Under paragraph (b)(1) of Interpretation and Policy .01 to Rule 1.1(ggg), a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, counts as one order even if the "child" orders are routed across multiple exchanges. In this case, complex orders (with eight legs or fewer) under Rule 6.53C(c)(iv) that are broken up into multiple leg orders by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer in order to execute the same "parent" order on the same side of the same series (series plural/product) as those comprising the parent order count as one order.

Question 11: If a broker "legs" a complex order (with eight legs or fewer) by executing the leg components as separate transactions, does the order still count as one order?

Answer: Yes. Under paragraph (b)(1) of Interpretation and Policy .01 to Rule 1.1(ggg), a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, counts as one order even if the "child" orders are routed across multiple exchanges. In this case, if a customer places a complex order (with eight legs or fewer), which is legged for execution by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, into multiple leg orders in order to execute the same "parent" order on the same side (net debit/credit) of the same series (series plural/product), the order still counts as one order.

Question 12: If a broker breaks a complex order (with eight legs or fewer) into multiple smaller proportionate size "child" orders that are otherwise identical to the "parent" order (with respect to leg-series, ratio, and terms), does the order still count as one order?

> *Answer:* Yes. A complex order that is broken into multiple "child" orders on the same side (buy/sell) and series and ratio as the "parent" order by a broker, counts as one order. Side and series mean net debit/credit and "series" are plural (i.e. same side (buy/sell) at the product level) with respect to complex orders under paragraph (b)(1) to Interpretation and Policy .01 to Rule 1.1(ggg).
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> Example: Customer places an order to sell 100 iron condors in class XYZ for $100. A broker then breaks the order into four separate orders of 25 iron condors each. This counts as one order. Notably, if the "parent" order were to be repriced to sell the same 100 iron condors in class XYZ for $110, the update would count as a new order.

Question 13: If a customer places a volatility order with a broker to buy (sell) a certain level of volatility in a single option series, which results in multiple "child" cancel/replaces, would each replace order need to be counted as a separate order?

> *Answer:* No. Under paragraph (c)(2) to Interpretation and Policy .01 to Rule 1.1(ggg), an order that cancels and replaces any "child" order resulting from a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker, or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer, but which is housed with the customer, does not count as a new order. Thus, if a customer places an order to buy (sell) a specific option series at a certain volatility, which then generates "child" cancel/replaces in order to maintain the "parent" order's volatility level in relation to movements in the underlying, the original volatility order counts as one order so long as the "child" orders are generated on the same side of a single series. Notably, if the customer were to change the volatility on the "parent" order, the new volatility order would count as an additional order. Conversely, if a customer were to enter an order to buy a certain level of volatility (or any other strategy), which then generated orders across multiple series, each "child" order in each series would count as a new order.

Question 14: Does a One-Cancels-the-Other (OCO) order count as multiple orders?

> *Answer:* No. The Exchange does not accept OCO orders. Therefore, an OCO order is, by definition, an instruction, which at most may only route one order to the Exchange. As such, pursuant to paragraph (b)(1) of Interpretation and Policy .01 to Rule 1.1(ggg), an OCO order, which is placed by a customer, but housed at a broker or dealer with instructions that only one order may be generated and routed to any exchange, counts as one order.

Question 15: If a customer places a reserve order or similar type order that automatically replenishes, does each "replenish" need to be counted?

> *Answer:* No. Similar to a single line volatility order, under paragraph (c)(2) to Interpretation and Policy .01 to Rule 1.1(ggg), an order that cancels and replaces any "child" order resulting from a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker, or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer, but which is housed with the customer, does not count as a new order. Thus, if a customer places a reserve order in a single line that automatically replenishes on the same side in the same single line, the original order counts as one order.

Question 16: Do orders linked by exchanges count as new orders?

Answer: No. Orders linked by exchanges (or exchange outbound routing brokers) in the course of fulfilling their obligations under the Options Order Protection and Locked/Crossed Market Plan do not need to be counted.

Question 17: If a parent order generates child orders that are pegged to the NBBO, do I have to count each cancel/replace of a child order?

Answer: Yes. Under paragraph (c)(4) to Interpretation and Policy .01 to Rule 1.1(ggg), an order that cancels and replaces any "child" order resulting from a "parent" order being "pegged" to the BBO or NBBO or that cancels and replaces any "child" order pursuant to an algorithm that uses BBO or NBBO in the calculation of "child" orders and attempts to move with or follow the BBO or NBBO of a series counts as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO. In this case, a pegged order would count as a new order each time a cancel/replace child order is used to follow the NBBO (regardless of who/what generated the cancel/replace order).

Question 18: For purposes of paragraph (b)(2) to Interpretation and Policy .01 to Rule 1.1(ggg) what does the term "strategy order" mean?

Answer: For purposes of Interpretation and Policy .01 to Rule 1.1(ggg) and specifically paragraph (b)(2) thereunder only, the term "strategy order" means a specific execution strategy or order instruction such as a volatility order, vega order, basket trade, program trade, portfolio trade, basis trade, or benchmark hedge, which will generate multiple orders either on multiple sides (buy/sell) or series. It does not mean a "complex" order. This definition of "strategy order" is not intended to extend to any other Rule. This concept is explained in further detail in the purpose section of SR-CBOE-2016-005, including the examples therein.

- **Review and Aggregation of Customer Accounts/Beneficial Ownership**

Question 19: How often must a TPH review orders for the Professional designation?

Answer: TPHs are required to conduct at least quarterly reviews of customers' activity and make any appropriate changes to the way in which they represent orders within five days after the end of each calendar quarter.

Question 20: Is it possible for a Professional to revert back to a non-Professional, public customer after having been identified as a Professional?

Answer: Yes. The Professional designation is based on review of a customer's past activity on at least a quarterly basis. Assuming that a customer's activity is reviewed once per quarter, if a customer exceeds the 390 average daily order threshold during any month of the quarterly review period, the customer would qualify as a Professional and the customer's orders would need to be marked with the order origin code "W" during the entire next quarter. Thereafter, however, if the customer places 390 orders or fewer per day on average each month during the next quarter, the customer would no longer qualify as a Professional and the customer's orders would be entitled to be marked with the order origin code "C" during the following quarter.

Question 21: If a non-broker-dealer person or entity places orders for multiple accounts, do the orders need to be aggregated?

Answer: Yes. All orders for accounts controlled by the same person or entity must be aggregated when determining whether or not the 390 average daily order threshold has been exceeded by that person or entity.

Question 22: Can a customer disaggregate/segregate trading activity for purposes of the 390 average daily order threshold calculation?

Answer: No. TPHs should also take note that the rule requires the aggregation of all beneficial accounts of a person or entity when calculating the number of orders placed. A person or entity cannot avoid designation as a Professional by spreading their activity over multiple accounts. TPHs should also take note that the rule does not permit the disaggregation of a person's or entity's account(s) when calculating the number of orders placed.

Example: Customer A is a non-broker-dealer limited liability company with three LLC members. All orders placed for the account(s) of Customer A must be aggregated when calculating the number of orders placed for Customer A. That Customer A may have an account(s) organized into sub-accounts or in some other manner to disaggregate/segregate trading activity of, and/or sub-allocate profits/losses to, the various LLC members is not relevant.

Question 23: If accounts have different Taxpayer Identification Numbers, is it okay to not aggregate them?

Answer: Not necessarily. TPHs need to recognize and aggregate orders from accounts that are obviously related to each other whether or not they have different taxpayer identification numbers. For example, if two accounts are named XYZ-I and XYZ-II and executions are regularly allocated between them, CBOE would expect a TPHs to aggregate orders placed for these accounts even though they might have different Taxpayer Identification Number.