



Regulatory Circular RG 00-169

To: Exchange Members and Member Organizations  
From: Legal Division and Regulatory Services Division  
Date: November 7, 2000  
Re: RAES Trade Busts/Adjusts

This Regulatory Circular seeks to describe circumstances in which RAES trades may be busted or adjusted.<sup>1</sup> In the absence of mutual agreement by both parties to a particular transaction, RAES trades may be either busted or adjusted by two Floor Officials and/or members of the appropriate Market Performance Committee<sup>2</sup> pursuant to CBOE Rule 6.8(a)(ii), which provides in part: “A trade executed on RAES at an erroneous quote should be treated as a trade reported at an erroneous price and adjusted to reflect the accurate market after receiving a Floor Official’s approval,” and Rule 6.20 Interpretation .05, which states: “Two Floor Officials may nullify a transaction or adjust its terms if they determine the transaction to have been in violation of any of the following: (i) Rule 6.43 (manner of bidding and offering), (ii) Rule 6.45 (priority of bids and offers), (iii) Rule 6.46 (transactions outside the book’s last quoted range), (iv) Rule 6.47 (priority on split price transactions), or (v) Rule 8.51 (trading crowd firm disseminated quotes).”

Erroneous quotes may be the result of one of the following occurrences:

Systems Problems

- A. Autoquote (Exchange or proprietary)
  - 1. Entire system failure.
  - 2. Failure by autoquote system to pick up underlying value. For example, underlying symbol change, or change in index calculation.
  - 3. Bad print in underlying causing erroneously updated option markets.

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<sup>1</sup> All unusual market situations cannot be anticipated. Therefore, it is important to note that this Regulatory Circular is not intended to provide an all-inclusive list of the only market situations in which RAES trades may be busted or adjusted under CBOE rules. To the contrary, there may be a number of other market situations in which RAES trades may be busted or adjusted under CBOE rules. Additionally, all of the precise circumstances of a particular market situation cannot be anticipated. Whether a RAES trade should be busted or adjusted in a particular market situation depends upon all of the circumstances existing at the time such action is under consideration. It is also important to note that this memo is not intended to convey that RAES trades should always be busted or adjusted in a particular market situation that is described in this memo. Instead, the memo provides examples of situations in which such action may be appropriate depending on the particular circumstances existing at the time, and Floor Officials should exercise their judgment in response to particular circumstances as to whether to adjust or bust RAES trades pursuant to CBOE rules.

<sup>2</sup> CBOE Rule 6.20 Interpretation .09 provides: “Members of the appropriate Market Performance Committee may perform the functions of a Floor Official for the purpose of enforcing trading conduct policies, including but not limited to, enforcing policies and acting pursuant to rules related to the Retail Automatic Execution System, fast markets, and the firm quote requirement of Rule 8.51(a).”

B. Related Systems

1. System delay in dissemination of autoquote generated markets to the public results in RAES orders based upon stale quotes.
2. Failure by dissemination systems to pick up autoquote markets.
3. Related systems problems that effect the ability to update autoquote.

II. Human Error

- A. Error by quote reporter in updating markets.
- B. Book bid or offer taken out, but delay in removal from book system results in subsequent RAES trades based upon market that no longer exists.
- C. An erroneously disseminated quote created by a Floor Broker's manually updated bid or offer which has been filled and is no longer available, but which (despite the broker's and quote reporter's best efforts) has not yet manually been removed from the disseminated quotes.
- D. Operator error in inputting autoquote parameters.<sup>3</sup>

In the case of an erroneous quote resulting from human error as described in II B and C above, the first RAES trade up to the firm quote requirement shall be honored.<sup>4</sup> Where Floor Officials have determined that subsequent RAES trades are eligible for a price adjustment or bust, all such RAES trades at that same erroneous quote must be treated comparably. Floor Officials recognize that human error may be a factor in busting or adjusting RAES trades, however, pursuant to Exchange Rule 8.7, market-makers in the crowd are expected to be diligent in performing their market making functions. In short, a RAES trade may be busted or adjusted when there is a bona fide error, and not in an instance where the crowd was negligent, or lax in performing its market making duties. The decision is made on a case by case basis, taking into consideration all relevant factors contributing to the dissemination of erroneous quotes.

Once it is concluded that one or more RAES trades were executed on erroneous quotes, the accurate market is generally determined by reference to one or more of the following quotes (as they existed at the time of the original execution of the option trade): the national best bid or offer for the option series, the quotes in the underlying security, and the quotes in related instruments. The trades are then either adjusted (in the case of a market order or a marketable limit order) to reflect the accurate market, or busted (in the case of a non-marketable limit order.)

Questions concerning this circular may be directed to members of the Trading Floor Liaison group at (312) 786- 4068, Douglas Beck, Regulatory Services Division, at (312) 786-7959, or to Andrew Spiwak, Legal Division, at (312) 786-7483.

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<sup>3</sup> Such mistakes do not include misjudgments in calculating autoquote parameters. Floor Officials shall determine whether such quote mistakes are the result of operational errors.

<sup>4</sup> Rule 8.51 Interpretation and Policy .02 requires the floor broker, DPM, OBO or market maker who has caused a quote to be posted and disseminated to take down that quote when it is no longer valid. Failure to do so may result in the failing party being held responsible to fulfill the firm quote commitment of Rule 8.51(a). Floor Officials shall determine who shall be held for the first RAES trade resulting from such a quote, based on all of the facts and circumstances surrounding the dissemination of the quote and the failure of the quote to be removed when no longer representing a valid market.