



Regulatory Circular RG01-42

Date: March 30, 2001
To: Members
From: Legal Division
Re: Firm Quote Rule

SEC Quote Rule

The SEC recently adopted changes to its Quote Rule that, among other things, extend the SEC's Firm Quote Rule to the options market. The Firm Quote Rule requires that quotation information made available to vendors be "firm," subject to certain exceptions. The regulation requires that options quotes be firm for broker-dealer orders, as well as for customer orders.

The Exchange must comply with this rule by Monday, April 2, 2001.

Therefore, Rule 8.51 has been amended to comply with the SEC's Firm Quote Rule. Rule 8.51 has been changed in the following ways:

Who is obligated for the firm quote requirement or size?

- Rule 8.51 tracks the language of the SEC Rule and says that the "responsible broker or dealer" is obligated for the firm quote requirement. The Rule defines "responsible broker or dealer" as the trading crowd in a series or class of option. So, as today, it is the trading crowd that is responsible for the firm quote requirement.

What does the firm quote requirement apply to?

- **The firm quote requirement now applies to all classes and series of options traded on the exchange.** Previously, only those classes and series designated by the Market Performance Committee were subject to the firm quote rule.
- The firm quote requirement applies to broker-dealer orders, as well as non-broker-dealer orders. The firm quote requirement may be different for broker-dealer orders than it is for non-broker-dealer orders.
- For non-broker-dealer orders, if the Exchange decides to disseminate quotation sizes, to OPRA, the firm quote requirement will be up to the disseminated size.

Who determines the size of the firm quote requirement?

- The appropriate Floor Procedure Committee has the authority to set the firm quote requirement for both types of orders.

What will the firm quote requirement be as of April 2, 2001?

- The various Floor Procedure committees have established the firm quote requirement for broker-dealer orders as 1 contract. The requirement for customer (non-broker-dealer) orders will be the same as it is today.

What is the “Trade or Fade” requirement under the new rule?

- Under the 30 Second Rule (See, 8.51(d)) when the trading crowd receives an order larger than the firm quote requirement for that class or series of option, it must within 30 seconds of receipt either execute the entire order, or execute a portion of the order equal to the firm quote requirement and revise its bid or offer. For purposes of this Rule, an order is considered to be received in the trading crowd when it is represented.

Is the trading crowd always obligated for the firm quote requirement?

- The trading crowd is not obligated for the firm quote requirement in the following situations:
 1. **Unusual Market Conditions.** If the Exchange is incapable of collecting, processing and making bids, offers, and quotation size (if applicable) available to quotation vendors because of the level of trading activity or unusual market conditions, then two Floor Officials or the Senior Person then in charge of the Control Room may determine that a class or series of option is in non-firm mode. When a class or series of option is in non-firm mode, the trading crowd is not obligated for the firm quote requirement.
 - When an option or series is in non-firm mode, the Exchange will send a message to quotation vendors and OPRA that the displayed quotes are not firm.

(OPRA will now use the “f” indicator to mean that a class or series of option is “non-firm” for that quotation. CBOE may continue to declare “fast markets” in situations where firm quote is not waived. In situations where a fast market is declared but firm quote is NOT waived an “f” will NOT be disseminated over OPRA but the Exchange will notify the trading floor of the action it is taking under a “fast” determination.)
 - Whenever a class or series of option is in a non-firm mode, the Floor Officials are required to monitor the situation at least every 30 minutes and either reaffirm the non-firm mode or lift the not firm designation.
 - Even though a class or series of option is in non-firm mode, the trading crowd is still responsible to use its “best efforts” to REPORT bids and offers or revised bids and offers.

2. Revised Quotation.

- The firm quote requirement for the displayed bid or offer will not apply, if prior to an order being presented, a bid, offer or quotation size is revised.
- The firm quote requirement also will not apply, if at the time the order is presented, a responsible broker or dealer is in the process of effecting a transaction in that class and/or series of option, and immediately after the completion of such transaction, it communicates to the exchange a revised bid, offer or quotation size. However, the firm quote requirement will apply to the revised bid, offer or quotation size.

3. Trading Rotation. The trading crowd is NOT obligated for the firm quote requirement during a trading rotation in that listed option.

Have any of the interpretations changed?

- The substantive changes, which are discussed below, deal with interpretations .03, and .07. There has also been a new interpretation .08 added, which is also discussed below.
- **Old Interpretation .03.** This interpretation is inconsistent with the SEC Quote Rule and has been deleted. Under this interpretation, orders for less than the firm quote requirement did not have to be reflected in the displayed market quote. The SEC Quote Rule requires the responsible broker or dealers to provide and the Exchange to display the best bids and offers in a contract. Therefore, this interpretation has been deleted. (Since interpretation .03 was deleted, all interpretations after .03 were renumbered.)
- **Interpretation .07.** Previously, this interpretation was interpretation .08 and it permitted two Floor Officials to suspend the firm quote requirement, when they declared a “fast market”. Under the new interpretation .07, when two Floor Officials declare a “fast market,” they may suspend the firm quote rule if they have made a determination that a level of trading activity or such unusual market conditions exists that makes the Exchange incapable of collecting, processing and making available to quotation vendors bids, offers and quotation sizes in a manner that accurately reflects the current state of the market on the floor.
- **Interpretation .08.** Under this interpretation, a trading crowd will not be responsible for the firm quote requirement if the Exchange or any quotation vendor publishes an erroneous bid or offer. If a published bid or offer is accurate but the published quotation size is inaccurate, then the trading crowd is only responsible for one contract.

How can I find out what the firm quote requirement is?

- The Exchange will periodically publish the firm quote requirement on the CBOE public website, www.cboe.com.

Are foreign broker-dealer orders considered broker-dealer orders for purposes of this Rule?

- Under the SEC Regulation, foreign broker-dealer orders would be considered non-broker-dealer orders. The Exchange has submitted to the SEC a request to permit the Exchange to treat foreign broker-dealer orders as broker-dealer orders for purposes of this Rule.

Will orders for the same class from the same beneficial owner receive the firm quote requirement for each order?

- The SEC Regulation does not permit the current exemption whereby firm quote treatment only needs to be given to the first orders of a group of orders for the same beneficial owner in the same class that are represented at approximately the same time. However, the Exchange has submitted to the SEC a request to permit the Exchange to maintain this exemption.

If you have any questions about this circular call Tim Thompson (312) 786-7070 or Madge Hamilton (312) 786-7572.