CHICAGO BOARD OPTIONS EXCHANGE

Regulatory Circular RG03-84

To: **CBOE Members and Member Firms**

From: **Equity Market Development and Performance Committee**
Equity Floor Procedure Committee

Date: **September 23, 2003**

Re: **Market Maker Quoting Obligations in Hybrid**

THERE ARE DIFFERENT MARKET MAKER OBLIGATIONS IN HYBRID CLASSES THAN THERE ARE IN NON-HYBRID CLASSES.

This circular summarizes the relevant obligations in Hybrid. These obligations only apply to Market Makers (MMs). DPMs have a continuous quoting obligation, as discussed below in Section III.

I. MM Obligations for First 90-days After a Class Begins Trading on Hybrid

For the first 90-days after a class begins trading on Hybrid, the following obligations will apply to MMs trading in that class:

- **Quote widths**: There are no maximum spread widths for electronic quotes.
- **Continuous Quoting**: There is no continuous electronic quoting obligation.
- **Open Outcry RFQs**: MUST respond to ALL verbal RFQs with a LEGAL-WIDTH 10-up market for customers and 1-up for BDs.
- **Quote Size**: Initial quote size must be for at least 10-contracts. Once the size decrements to zero, the MM must replenish to at least 10-contracts.

II. MM Obligations AFTER the First 90-days

After the 90-day introductory period, the extent of a MM's obligations in a class depends upon how much volume the MM traded electronically in that class during the preceding quarter: less than 20% or more than 20%. Once a MM trades more than 20% of his/her volume electronically during a quarter, he/she will ALWAYS be subject to the obligations in paragraph B. below for that class even if the MM subsequently trades less than 20% electronically.

A. MM Trades <u>LESS</u> than 20% of His/Her Contract Volume Electronically

If a MM never trades more than 20% of his/her volume electronically, he/she will have the same obligations as described in paragraph I above. WARNING: When a MM is subject to these specific obligations (because he/she trades less than 20% of his/her volume electronically) ANY volume traded electronically by that MM will NOT count towards his/her in-person requirement.

B. MM Trades <u>MORE</u> than 20% of His/Her Contract Volume Electronically

Once a MM on Hybrid trades more than 20% of his/her contract volume electronically in a class, the following obligations will ALWAYS apply to him/her in that class:

- **Quote Widths**: Electronic quotes MUST be no wider than legal width[1]
- **Open Outcry RFQs**: MUST respond to ALL verbal RFQs with a LEGAL-WIDTH 10-up market for customers and 1-up for BDs
- **Quote Size:** Initial quote size must be for at least 10-contracts. Once the size decrements to zero, the MM must replenish to at least 10-contracts.
- **Continuous Quoting Obligation:** MM must continually quote X% of the series. "X" depends on how much of <u>CBOE's</u> volume in that class trades electronically:

% of Class Volume Transacted Electronically	Electronic Quoting % Requirement (Percentage of series)
50% or Below	20%
51-75%	40%
Above 75%	60%

For example, if 83% of the total volume on CBOE in class XYZ traded electronically the previous quarter, MMs in the class must continuously quote 60% of the series.

III. DPM Obligations

DPMs must quote a continuous, legal-width market in all series.

IV. Firm Quote Obligations

Each individual MM's quotes are firm quotes and must be honored in accordance with CBOE's Firm Quote Rule 8.51. This is different from non-Hybrid classes in which the crowd shares the responsibility for the quote. The firm quote size for customers is the disseminated size. The firm quote size for BDs is one contract.

[1] The maximum permissible spread widths are as follows: $0.25 for options under $2, $0.40 for options above $2 but not over $5, $0.50 for options above $5 but not over $10; $0.80 for options above $10 but not over $20; and $1 for options above $20

V. “Quote Aping” and Anticompetitive Conduct

In the Hybrid Approval Order, the SEC stated:

> Although it is not unlawful for a market maker to take the prices offered by its competitors into account when setting its own prices, or to follow or copy prices of its competitors, such a decision must be a unilateral business judgment not intended to harass or punish a competitor for improving prices or otherwise acting competitively and not the result of collusive agreement. Accordingly, the Commission expects that the CBOE will surveil its market to ensure that market makers are not coordinating quotes in the Hybrid system or engaging in other anticompetitive conduct.

The Exchange will surveil for such conduct.

Any questions regarding this circular should be addressed to Daniel Hustad at (312) 786-7715 or Steve Youhn at (312) 786-7416.