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Regulatory Circular RG03-117

Date: December 17, 2003
To: Members and Member Firms
From: Regulatory Services Division
Re: Marking Options

The CBOE is issuing this Circular as a reminder that Marking is a form of manipulation that violates Exchange and U.S. Securities and Exchange Commission rules. Marking interferes with the true determination of the market value of an option and conveys false information to the marketplace.

Marking includes, but is not limited to, the following:

- the act of changing the final disseminated price or the disseminated bid/ask quote of an option series for the purpose of influencing the mark-to-the-market value of the option or to reflect a price which is not representative of the true state of the market.
- entering orders at or near the close of trading for the purpose of changing the final disseminated bid/ask quote of an option series
- unauthorized use of TNT terminals to disseminate the final price or bid/ask quote of an option series
- the submission of fictitious transactions that change the closing market price. Fictitious transactions may also constitute a fraud, in violation of both Exchange Rules and the Securities Exchange Act of 1934, as amended, and various rules thereunder.

Any member or person associated with a member who engages in Marking activity may be subject to all or some of the following Exchange rule violations:

- Marking is a form of manipulation and thus, is a violation of Rule 4.7(a) - **Manipulation**.
- Marking is conduct which is inconsistent with just and equitable principles of trade in violation of Rule 4.1 - **Just and Equitable Principles of Trade**.
- Rule 4.6 – **False Statements**¹ in that no member shall make any false statements or misrepresentations to the exchange with respect to reporting of any Exchange transaction.
- Rule 8.7 - **Obligations of a Market-Maker** in that it is inconsistent with a market-maker's affirmative obligations.
- Rule 6.13(c) - **CBOE Hybrid System's Automatic Execution Feature**, Users, Order Entry Firms, and Prohibited Practices

Marking may also constitute a violation of the following sections of Securities Exchange Act of 1934:

- Section 9(a)(2) - **Prohibition against Manipulation of Security Prices**
- Section 10(b) - **Regulation of the Use of Manipulative and Deceptive Devices** and Rule 10b-5 - **Employment of Manipulative and Deceptive Devices** thereunder.

¹ There is a pending rule filing with the SEC regarding this rule. Upon approval, the rule name will be changed to **Misrepresentations or Omissions**.

In appropriate cases, the Exchange may charge violations of the federal securities laws listed above. Members should also be aware that because marking is a violation of the federal securities laws, the SEC and the Justice Department could exercise their jurisdiction and pursue an action.

It should be noted that the Regulatory Services Division recognizes that trade activity or quote changes near the end of the day are in and of themselves not improper. Additionally, in its analysis of possible marking activity, the Division takes into consideration the equity impact of the last sales, the relative change in price from the previous trade, the concurrent underlying stock price, degree and direction of price movement, whether the last sales appear to have filled customer orders, whether a pattern of unexplained activity is apparent, and other relevant information. The Department of Market Regulation conducts reviews on a routine basis to identify quote changes and trading activity possibly effected for the purpose of influencing option mark-to-the-market values and will refer all possible marking violations to the Business Conduct Committee for disciplinary action. Should the BCC find that probable cause exists to allege that marking activity occurred, sanctions that could be imposed include: bar or suspension from Exchange membership or association with a member, censure, fine, and disgorgement of profits. Also, marking activity by members of a trading crowd will be taken into consideration by the Market Performance Committee when evaluating a trading crowd's performance and may result in remedial action being taken by the Market Performance Committee under Exchange Rule 8.60-**Evaluation of Trading Crowd Performance**, notwithstanding any action taken by the Business Conduct Committee. The Committees believe it is in the best interest of all members, market-makers and floor brokers alike, to ensure that the credibility of our marketplace is not compromised due to the marking of options.

Questions concerning this matter may be directed to Joanne Heenan at (312) 786-7786, or Lisa Trzeciak (312) 786-7906.

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