



Regulatory Circular RG03-120

To: Members
From: Legal Division
Date: December 30, 2003
Re: Obvious Error Rule Approval

The SEC recently approved CBOE's obvious error rule (Rule 6.25). Rule 6.25 provides the exclusive means for nullifying or adjusting electronic trades in both Hybrid and non-Hybrid classes.¹ This Regulatory Circular provides a brief summary of the new rule. In determining whether the obvious error rule has any application to their transactions, members are advised to review and rely upon the full text of Rule 6.25 and not this summary. The text of the rule is available on the CBOE website.

Trades Subject to Review: There are six types of transactions that may be reviewed:

1. **Obvious Price Errors:** Trade price differs from fair market value (FMV) by: (a) the greater of \$0.10 or 10% for options under \$2.50; (b) 10% for options at or above \$2.50 and under \$5; or (c) \$0.50 for options at \$5 or higher. Generally, FMV equals the midpoint of the NBBO. May adjust or nullify these trades.
2. **Obvious Quantity Errors:** Trade Size exceeds an individual's average disseminated size over the previous four hours by five (5) times (can look at prior day). Adjust back to average size.
3. **Verifiable Disruptions or Malfunctions of Exchange Systems:** Trades arising out of a "verifiable disruption or malfunction" in the use or operation of any **Exchange** automated quotation, dissemination, execution, or communication system may be nullified or adjusted.
4. **Erroneous Print in Underlying:** Erroneous print must be higher or lower than the average trade in the underlying during a two-minute period before and after the bad print in question by at least five times the average quote width during the same period. May adjust or nullify.
5. **Erroneous Quote in Underlying:** An erroneous quote occurs when the underlying is at least \$1.00 wide and five times wider than the average quote width for underlying on the primary market during a two-minute period before and after the "bad" quote. May adjust or nullify.
6. **Trades Below Intrinsic Value:** Trades must be more than \$0.10 below parity. This provision does NOT apply during the last two minutes of the trading day. Parity for a call equals the stock price minus the strike price. Parity for a put equals the strike price minus the stock price. For long calls/short puts, measure from underlying bid. For long puts/short calls, measure from underlying offer. May bust or adjust to \$0.10 under parity (provided doesn't violate limit price).

¹ Trades executed in open outcry continue to be subject to Rule 6.20.05.

Notification: Absent unusual circumstances, members must notify a Trading Official (TO) within 15 minutes after the execution. For trades after 2:45 p.m., must notify within 15 minutes after the close. For “verifiable systems problems,” Trading Officials must initiate action within 60 minutes of the occurrence.

Review and Determination: Absent unusual circumstances, TOs must render a decision within 60 minutes of receiving notice. For trades after 2:30 p.m., TOs have until 9:30 a.m. the next day to decide.

Adjustments: Adjust to the NBB (NBO) immediately following the erroneous trade(s) provided it does not violate the customer’s limit. Use NBB for sells, NBO for buys. For ROS or HOSS, adjust to first non-erroneous quote after the erroneous transaction on CBOE.

Revoked Effectiveness of Rules: Effective immediately, RG00-169 and Rule 6.8(d)(iii) are no longer effective and may NOT be used as the basis for adjusting or nullifying trades. Also, it is impermissible to use Rule 6.20.05 as a means to adjust or nullify a trade solely because that trade can not be nullified or adjusted under Rule 6.25.

For more information, please contact Trading Floor Liaisons, Andrew Spiwak at (312) 784-7483, or Steve Youhn at (312) 786-7416.