



Regulatory Circular RG05-108

DATE: November 11, 2005

TO: Members and Member Firms

FROM: Regulatory Services Division

RE: Description of Procedures for the ROS Opening on Volatility Index Futures and Options Contract Settlement Days

This regulatory circular describes procedures for the modified Rapid Opening System (ROS) opening procedure on the settlement days of volatility index futures and option contracts for which the index options used to calculate the volatility index do not trade on the Hybrid Trading System. CBOE notes that it currently does not trade volatility index options. This circular will be applicable to options that do not trade on Hybrid that are used to calculate a volatility index at such time that CBOE lists options on that volatility index.

The modified ROS opening procedure is currently used for SPX options on settlement days for CBOE Volatility Index (VIX) futures. Since DJX options trade on Hybrid, the Hybrid Opening System (HOS) is used for DJX options on settlement days for CBOE DJIA Volatility Index futures contracts and the modified ROS opening procedure has no applicability to the DJX option class.

The settlement date for listed volatility index futures and options contracts is on the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which the applicable volatility index futures or options contract expires. On the settlement dates, CBOE Rule 6.2A.03 provides for a modified ROS opening procedure only in those index option series (i) whose prices are used to calculate a volatility index on which a future or option is traded and (ii) that are not traded on Hybrid. The normal ROS opening procedure will occur on all other days in those index options and on the volatility index futures and options settlement date in all contract months whose prices are not used to calculate the applicable volatility index.

Orders Eligible for Participation in the Modified ROS Opening Procedure

On the final settlement date of a volatility index future or option with respect to which the modified ROS opening procedure is utilized, all index option orders (including public customer, broker-dealer, CBOE market-maker and away market-maker and specialist orders), other than contingency orders, may be placed in the electronic book only in those series of the index option contract month whose prices are used to calculate the applicable volatility index. The option contract prices used in the volatility index on the final settlement date will always be the prices in the contract month immediately following the month of the final settlement date for the applicable volatility index futures or options contract (*e.g.*, a June 05 final settlement date for volatility index futures and options contracts will use July 05 option prices to calculate the volatility index). Since the other option contract months are never used in the calculation of a volatility index on the final settlement date, market-maker and broker-dealer orders may not be placed in the electronic book for those months in options contracts for which ROS is utilized. In

addition, in order to participate in the modified ROS opening procedure, all orders for placement in the electronic book, and any change to or cancellation of any such order, must be received prior to 8:25 a.m. (or 8:00 a.m. if the circumstances described below are applicable).

Order Submission Deadlines for Participation in Modified ROS Opening Procedure

All index option orders for participation in the modified ROS opening procedure that are related to positions in, or a trading strategy involving, volatility index options or futures, and any change to or cancellation of any such order

(A) must be received prior to 8:00 a.m. and

(B) may not be cancelled or changed after 8:00 a.m., except that any such order may be changed or cancelled after 8:00 a.m. and prior to 8:25 a.m. in order to correct a legitimate error, in which case the member submitting the change or cancellation shall prepare and maintain a memorandum setting forth the circumstances that resulted in the change or cancellation and shall file a copy of the memorandum with the CBOE Department of Market Regulation no later than the next business day.

In general, the Exchange shall consider index option orders to be related to positions in, or a trading strategy involving, volatility index options or futures for purposes of Rule 6.2A.03 if the orders possess the following three characteristics:

- (1) The orders are for options series with the expiration month that will be used to calculate the settlement price of the applicable volatility index option or futures contract. (For example, in the case of VIX futures, the orders would be in SPX option series that expire one month following the settlement date of the expiring VIX futures contract).
- (2) The orders are for options series spanning the full range of strike prices in the appropriate expiration month for options series that will be used to calculate the settlement price of the applicable volatility index option or futures contract, but not necessarily every available strike price.
- (3) The orders are for put options with strike prices less than the "at-the-money" strike price and for call options with strike prices greater than the "at-the-money" strike price. The orders may also be for put and call options with "at-the-money" strike prices.

Whether index option orders are related to positions in, or a trading strategy involving, volatility index options or futures for purposes of Rule 6.2A.03 depends upon the specific facts and circumstances. This circular is intended to provide guidance regarding what types of orders would generally be considered to fall within this category of orders. Other types of orders may also be deemed by the Exchange to fall within this category of orders if the Exchange determines that to be the case based upon the applicable facts and circumstances.

Market-Maker and Broker-Dealer Order Submission Procedures

Market-makers not in the applicable index option pits and broker-dealers must electronically submit orders for placement in the electronic book for the modified ROS opening procedure. Market-makers in the applicable index option pits may submit orders for placement in the electronic book for the modified ROS opening via one of the following methods:

1. Submit the order to a floor broker that has access to CBOE's Order Routing System (ORS).
2. Submit the order through a hand-held terminal that has futures/options routing functionality (e.g., FOC, REDI).
3. Submit a paper ticket to the Order Book Official (Note: Only paper tickets for market orders will be accepted – limit orders may not be submitted via paper ticket for placement in the electronic book for participation in the ROS opening).

All market maker orders should designate the market-maker account in the CMTA field of the order.

CBOE's trading systems automatically cancel market-maker and broker-dealer orders that are entered in the electronic book for the modified ROS opening procedure but are not executed at the opening in the option contract months whose prices are used to calculate a volatility index. Therefore, market-makers and broker-dealers are not required to cancel these orders immediately following the opening.

Market-Maker Requirements in the Modified ROS Opening Procedure

All market-makers, including LMMs, who are required to log on to ROS or RAES for the current expiration cycle are required to log on to ROS during the modified ROS opening procedure if the market-maker is physically present in the applicable trading crowd. On the Wednesday of a volatility index futures or options contract settlement only, all LMMs will collectively set the Autoquote values that will be used by ROS to calculate the opening prices for all series in the applicable index options contracts whose prices are used to calculate the volatility index. ROS contracts to trade in the applicable index options will be assigned equally, to the greatest extent possible, to all logged-on market-makers, including the LMMs.

LMMs are required to set Autoquote values for the modified ROS opening procedure consistent with their obligation to price option contracts fairly. In addition, members submitting orders for placement on the electronic book may not do so for the purpose of creating or inducing a false, misleading, or artificial appearance of activity or for the purpose of unduly or improperly influencing the opening price or settlement or for the purpose of making a price which does not reflect the true state of the market. Violations of these requirements are subject to disciplinary action.

Signing on to ROS for the Modified ROS Opening Procedure

All market-makers who are required to log on to ROS for the modified ROS opening procedure must do so prior to 8:25 a.m.

Signing on to ROS requires a change in the market-maker's profile found on the RAES sign-in terminal. All market-makers signed on to RAES that are not LMMs are signed on using the letter 'Z' in the field before the affected class symbol. Signing on to ROS as well as RAES requires that the letter 'Z' be changed to a 'B' for both (ROS & RAES).

Prior to signing on for the day, type in the market-maker's acronym and password and hit F15 once. Change the 'Z' in front of the necessary symbols to 'B' and hit F15 again.

At some point after the opening and prior to the next ROS opening, market-makers that are not LMMs must change their profile to once again show a 'Z' indicating RAES only.

Any questions regarding this circular may be directed to Steve Slawinski of the Regulatory Division at 312-786-7744 or Patrick Fay of the CBOE Futures Exchange at 312-786-7925.

(Replaces RG05-86)