CBOE
CHICAGO BOARD OPTIONS EXCHANGE

Regulatory Circular RG06-63

To: Exchange Members and Member Organizations

From: Legal Division

Date: June 23, 2006

Re: Recent Amendment to Exchange Rule 6.25. Nullification and Adjustment of Equity Options Transactions

The Securities and Exchange Commission recently approved an amendment to Exchange Rule 6.25 relating to transactions during **opening rotation** between a non-broker-dealer Customer and CBOE Market-Maker(s) or a non-CBOE Market-Maker(s). This rule amendment provides that after the fifteen minute notification period as described in Exchange Rule 6.25(b)(1) and until 3:30 pm central time ("CT") on the subject trade date, where parties to the transaction are a non-broker dealer customer and CBOE Market-Maker(s), the non-broker-dealer customer may request review of the subject transaction, and the execution price of the transaction will be adjusted (provided the adjustment does not violate the customer's limit price) by Trading Officials to the prices provided in Rule 6.25(i) Paragraphs (A) and (B), without the adjustment penalty, unless both parties agree to adjust the transaction to a different price or agree to bust the trade within fifteen (15) minutes of being notified by Trading Officials of the Obvious Error. The option contract quantity of any adjustment shall not exceed the disseminated size by the competing options exchange that has the most liquidity in that option class in the previous two calendar months. In the event a non-CBOE Market-Maker is also party to the transaction, the execution price of the transaction will be adjusted provided the adjustment does not violate non-CBOE Market-Maker's limit price.

Example

In a hypothetical situation, a non-broker-dealer customer ("Customer XYZ") enters a limit order to buy 100 contracts in an options class at $3.80 prior to the opening. Assume that prior to the opening, a Market-Maker ("Market-Maker A") was offered at $3.80 for 50 contracts and prior to the opening, a non-CBOE Market-Maker ("BD Firm ABC") entered an order to sell 50 contracts at a price of $3.80. Now assume that the Hybrid Opening System ("HOSS") established an opening price of $3.80 and the opening rotation is complete and Customer XYZ purchased 100 contracts at $3.80 during opening rotation.

For purposes of this example, the away competing exchange with the most liquidity in the option class in the previous two calendar months is the International Securities Exchange ("ISE"). However, Customer XYZ did not check the execution status of his order until 12:30 pm CT (more than the 15 minute notification period for a nullification under Exchange Rule 6.25(b)(1)). Disseminated quote and size for the option class at ISE at the time the 100 contracts printed from the opening HOSS rotation on CBOE at a price of $3.80 was:

Exchange	Bid	Offer	Size
ISE	$3.30	$3.40	100x100

Because the $3.80 price is at least $.40 higher than the best offer on the ISE, these trades would be obvious price errors under Exchange Rule 6.25. Pursuant to the proposed rule, 50 option contracts Customer XYZ executed against Market-Maker A would have a price adjustment to $3.40 (obvious error trades with a CBOE Market-Maker will be adjusted to the disseminated price for the disseminated size listed on the competing exchange with the most liquidity in the options class for the preceding two months (here, ISE)). The 50 option contracts executed with BD Firm ABC would execute at $3.80, because adjustments will not exceed a non-CBOE Market-Makers limit price (here BD Firm ABC had a limit price of $3.80). The adjustment involving the transaction against the Market-Maker could occur as long as the non-broker-dealer customer reported the obvious error more than 15 minutes after the erroneous transaction occurred, but before 3:30 pm CT on the same trading day.

Questions regarding this circular may be addressed to Andrew Spiwak, Legal Division at (312) 786-7483 or Craig Johnson of TFL at (312) 786-7939.