



## Regulatory Circular RG07-06

To: Members and Member Organizations  
From: Legal & Regulatory Services Divisions  
Date: January 17, 2007  
RE: SPX Combination Orders

The purpose of this Regulatory Circular is to remind SPX traders of the requirements for executing SPX Combo Orders pursuant to CBOE Rule 24.20.

### Key Issues

- The purpose of Rule 24.20 is to facilitate the transaction of an "SPX Combo Order," which is defined in the Rule as an order to purchase or sell SPX options and the offsetting number of SPX combinations defined by the delta. An "SPX combination" is defined as a long (short) SPX call and a short (long) SPX put having the same expiration date and strike price. The "delta" is defined as the positive (negative) number of SPX combinations that must be sold (bought) to establish a market neutral hedge with an SPX option position.
- Rule 24.20 will allow a member holding an SPX Combo Order to execute and print the SPX Combo Order at the prices originally quoted within 2 hours after the time of the original quotes, provided that the prices originally quoted satisfy the requirements of Rule 24.20 (b)(1).
- When an SPX Combo Order is transacted, the prices of the component series of the order will be reported to the trading floor and to OPRA using the prefix "CMBO." All handwritten tickets and electronic execution systems, such as the Market-Maker Hand-Held Terminal, should designate the trade as "CMBO" when submitted to the Exchange for price reporting. The "CMBO" prefix acts as notice to the public that the reported prices are part of an SPX Combo Order.
- **Although other strategies may accomplish a market neutral hedge for SPX options, the relief applicable to SPX Combo Orders only applies if the requirements of Rule 24.20 are satisfied.**

### Discussion

The purpose of Rule 24.20 is to facilitate hedging SPX options with SPX combinations during times of market volatility. Prior to approval of Rule 24.20 in 2002, SPX market participants holding orders for options tied to combinations frequently experienced difficulty completing such transactions in a volatile market. If the order did not trade immediately, subsequent market volatility would often times prevent the trade from being completed as originally designed because the prices originally quoted for the component legs of the order could no longer be traded within the displayed market quotes, as required under Exchange rules.

Rule 24.20 provides limited relief to SPX market participants in this regard by allowing the component legs of an "SPX Combo Order," defined as an order to purchase or sell SPX options and the offsetting number of SPX combinations defined by the delta,<sup>1</sup> to be traded outside the market quotes ("out-of-range") under certain circumstances. Specifically, Rule 24.20 allows a member holding an SPX Combo Order to execute and print the SPX Combo Order at the prices originally quoted within 2 hours after the time of the original quotes, provided that the prices originally quoted satisfy the requirements of paragraph (b)(1) of Rule 24.20.

Paragraph (b)(1) of the Rule states the priority requirement for SPX Combo Orders in the same manner as CBOE Rules 6.45(e).<sup>2</sup> Specifically, when a member holding an SPX Combo Order and bidding

<sup>1</sup> See the "key issues" summary above for the definitions of an "SPX combination" and the "delta."

<sup>2</sup> Rule 6.45(e) provides a limited exception from the normal time and price priority rules for certain complex orders.

or offering in a multiple of the minimum increment on the basis of a total debit or credit for the order has determined that the order may not be executed by a combination of transactions with the bids and offers displayed in the SPX limit order book or by the displayed quotes of the crowd, then the order may be executed at the best net debit or credit so long as: (A) no leg of the order would trade at a price outside the currently displayed bids or offers in the trading crowd or bids or offers in the SPX limit order book and (B) at least one leg of the SPX combination would trade at a price that is better than the corresponding bid or offer in the SPX limit order book. Thus, SPX traders continue to be required to check the limit order book when an SPX Combo Order is first entered and before trading the order.

When an SPX Combo Order is transacted, the prices of the component series of the order will be reported to the trading floor and to OPRA using the new prefix "CMBO." The "CMBO" will act as notice to the public that the reported prices are part of an SPX Combo Order. All handwritten tickets and electronic execution systems, such as the Market-Maker Hand-Held Terminal, should designate the trade as "CMBO" when submitted to the Exchange for price reporting.

**Please be reminded that, although other strategies may accomplish a market neutral hedge for SPX options, the relief applicable to SPX Combo Orders only applies if the requirements of Rule 24.20 are satisfied.**

The Regulatory Services Division monitors member trading activity for compliance with Rule 24.20. Rule 24.20 does not diminish the obligation of CBOE members to obtain best execution for their customers. The appearance of a pattern or practice of failing to execute and report these trades pursuant to the Rule without exceptional circumstances may be subject to referral to the Exchange's Business Conduct Committee for formal disciplinary action.

If you have any questions concerning this circular, please contact Joanne Heenan-Hustad, Regulatory Services Division, at 312-786-7786, or Jennifer Lamie, Legal Division, at 312-786-7576. The complete text of Rule 24.20 is included below for reference.

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#### SPX Combination Orders

RULE 24.20 (a) For purposes of this rule, the following terms shall have the following meanings:

(1) An "SPX combination" is a long SPX call and a short SPX put having the same expiration date and strike price.

(2) A "delta" is the positive (negative) number of SPX combinations that must be sold (bought) to establish a market neutral hedge with an SPX option position.

(3) An "SPX Combo Order" is an order to purchase or sell SPX options and the offsetting number of SPX combinations defined by the delta.

(b) An SPX Combo Order may be transacted in the following manner:

(1) When a member holding an SPX Combo Order and bidding or offering in a multiple of the minimum increment on the basis of a total debit or credit for the order has determined that the order may not be executed by a combination of transactions with the bids and offers displayed in the SPX limit order book or by the displayed quotes of the crowd, then the order may be executed at the best net debit or credit so long as (A) no leg of the order would trade at a price outside the currently displayed bids or offers in the trading crowd or bids or offers in the SPX limit order book and (B) at least one leg of the SPX combination would trade at a price that is better than the corresponding bid or offer in the SPX limit order book.

(2) Notwithstanding any other rules of the Exchange, if an SPX Combo Order is not executed immediately, the SPX Combo Order may be executed and printed at the prices originally quoted for each of the component option series within 2 hours after the time of the original quotes.

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(This circular replaces Regulatory Circulars RG02-013 and RG02-016.)