



Regulatory Circular RG08-42

DATE: March 14, 2008

TO: Members and Member Firms

FROM: Regulatory Services Division

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

This regulatory circular replaces CBOE Regulatory Circular RG07-106 and describes current procedures for the modified Hybrid Opening System (HOSS) opening procedure on the settlement days of volatility index options and futures contracts for which the index options used to calculate the volatility index are Hybrid 3.0 classes.

The SPX option class is the only Hybrid 3.0 option class in which the modified HOSS opening procedure is utilized. Specifically, the modified HOSS opening procedure (which is described in CBOE Rule 6.2B.01) is utilized in certain SPX option series on settlement days for CBOE Volatility Index (VIX) options and futures contracts. Since DJX, NDX, and RUT options trade on the Hybrid 2.0 platform, the modified HOSS opening procedure is not applicable to these option classes. Rather the normal HOSS opening procedure (which is described in CBOE Rule 6.2B) is used to determine the opening prices for DJX, NDX, and RUT options on the settlement days for CBOE DJIA Volatility Index (VXD) futures contracts, CBOE Nasdaq-100 Volatility Index (VXN) options and futures contracts, and CBOE Russell 2000 Volatility Index (RVX) options and futures contracts.

The settlement date for volatility index options and futures 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 options or futures contract expires.¹ On these settlement dates, CBOE Rule 6.2B.01 provides for a modified HOSS opening procedure only in those index option series (i) that are Hybrid 3.0 classes and (ii) whose prices are used to calculate a volatility index on which an option or future is traded.² The normal HOSS opening procedure is used on all other days in those index options and on the volatility index options and futures settlement date in all contract months whose prices are not used to calculate the applicable volatility index.

¹ If the third Friday of the month subsequent to expiration of the applicable volatility index futures or options contract is a CBOE holiday, the final settlement date for the respective contract shall be thirty days prior to the CBOE business day immediately preceding that Friday.

² The modified HOSS opening procedure may be suspended by two Floor Officials in the event of unusual market conditions.

Orders Eligible for Participation in Modified HOSS Opening Procedure

The following order eligibility parameters are applicable in Hybrid 3.0 classes, including SPX options, both on regular trading days and on the final settlement date of a volatility index options or futures contract:

- (i) public customers, broker-dealers, CBOE Market-Makers, away Market-Makers, and Specialists may enter opening orders for participation in the opening rotation, including in the modified HOSS opening procedure; and
- (ii) spread orders and non-OPG contingency orders are not eligible to participate in the opening rotation, including the modified HOSS opening procedure.

Order Submission Deadlines for Participation in Modified HOSS Opening Procedure

In order to participate in the modified HOSS 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 the opening of trading (unless the circumstances described below are applicable).

All index option orders for participation in the modified HOSS 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 8:15 a.m. (CT), and

(B) may not be cancelled or changed after 8:15 a.m. (CT), unless the order is not executed in the modified HOSS opening procedure and the cancellation or change is submitted after the modified HOSS opening procedure is concluded (provided that any such order may be changed or cancelled after 8:15 a.m. (CT) and prior to the opening of trading 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 Exchange no later than the next business day in a form and manner prescribed by the Exchange).

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 6.2B.01 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 options 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 options 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 6.2B.01 depends upon the specific facts and circumstances. 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.

Order Submission Procedures for Modified HOSS Opening Procedure

All orders for participation in the modified HOSS opening procedure must be submitted electronically (either directly or indirectly through a floor broker).

Market-Maker orders for participation in the modified HOSS opening procedure must be submitted as either an "M" order or as an "N" order (as applicable), and all non-customer orders for participation in the modified HOSS opening procedure must have an OPG contingency. As is the case in Hybrid 3.0 classes generally, non-customer orders without an OPG contingency are not eligible to participate in the modified HOSS opening procedure.

As on regular trading days, CBOE's trading systems will automatically cancel any OPG orders that are entered for participation in the modified HOSS opening procedure which remain unexecuted upon the conclusion of that procedure.

Certain LMM and Member Requirements in Connection with Modified HOSS Opening Procedure

In addition to the LMM quoting requirements, LMMs are required to enter opening orders during the modified HOSS opening procedure. LMMs are also required to submit quotes and orders in connection with the modified HOSS opening procedure consistent with their obligation to price option contracts fairly.

Members submitting orders for participation in the modified HOSS opening procedure 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 and other requirements with regard to the modified HOSS opening procedure are subject to disciplinary action.

Publication of Order Imbalance Information in Connection with Modified HOSS Opening Procedure

Any imbalance of contracts to buy over contracts to sell in the applicable index option series, or vice versa, as indicated on the electronic book, as well as expected opening prices and sizes will be published on the CBOE and CFE websites. This information will be published as soon as practicable up through the opening bell on days that the modified HOSS opening procedure is utilized. Additionally, this information is displayed on monitors in the SPX trading crowd and is made available through CBOE's API.

Contact Information

Any questions concerning this notice may be directed to Bill Speth at 312-786-7141 or John Hiatt 312-786-7779 or Jenny Yeadon at 312-786-7466.

(Replaces RG07-106)