Regulatory Circular RG08-165

To: Members

From: Market Quality and Allocation Committee (MQAC)
Index Options Procedure Committee (IOPC)

Date: December 8, 2008

Re: Market-Maker Quoting Obligations for OEX on Hybrid

Due to Options on the Standard and Poors 100 Index (OEX) being converted to a Hybrid class on December 9, 2008, Market-Makers should be aware of their obligations in Hybrid classes.

This circular summarizes the relevant obligations in Hybrid. These obligations only apply to Market-Makers (MMs).

I. MM Obligations for First 90-days After a Class Begins Trading on Hybrid

For the first 90-days after a class begins trading on Hybrid, the following obligations will apply to MMs trading in that class:

- **Quote widths**: There are no maximum spread widths for electronic quotes.
- **Continuous Quoting**: There is no continuous electronic quoting obligation.
- **Open Outcry RFQs**: MUST respond to ALL verbal RFQs with a LEGAL-WIDTH 10-up market for customers and 1-up for BDs.
- **Quote Size**: Initial quote size must be for at least 10-contracts. Once the size decrements to zero, the MM must replenish to at least 10-contracts.

II. MM Obligations AFTER the First 90-days

After the 90-day introductory period, the extent of a MM's obligations in a class depends upon how much volume the MM traded electronically in that class during the preceding quarter: less than or equal to 20%, or more than 20%. Once a MM trades more than 20% of the MM's volume electronically in that class during a quarter, the MM will ALWAYS be subject to the obligations in paragraph B below for that class even if the MM subsequently trades less than 20% electronically.

A. MM Trades 20% or LESS Contract Volume Electronically

If a MM never trades more than 20% contract volume electronically, the MM will have the same obligations as described in paragraph I. above.

B. MM Trades MORE than 20% Contract Volume Electronically

Once a MM on Hybrid trades more than 20% contract volume electronically in a class for a calendar quarter, the following obligations will ALWAYS apply to a MM in that class:

- **Quote Widths**: Electronic quotes MUST be no wider than legal width.[1]
- **Open Outcry RFQs**: MUST respond to ALL verbal RFQs with a LEGAL-WIDTH 10-up market for customers and 1-up for BDs.
- **Quote Size:** Initial quote size must be for at least 10-contracts. Once the size decrements to zero, the MM must replenish to at least 10-contracts.
  Continuous Quoting Obligation: MM must continually quote 60% of the series that are less than 9 months to expiration.

III. OEX Hybrid Dials

- Trade allocation will be on a Pro-Rata basis.
- Quote-to-Quote Lock timer will be set to 1 second.
- Customer priority will be in place.
- A 30% LMM electronic and open outcry participation entitlement will be in place.
- OEX seat cost will be .40. (XEO seat cost will be .10.)
  COB, COA ($0.05 increments only) and HALO will be active. AIM, SAL, HAL, Payment for Overflow and Preferred Market Maker will not be available.

IV. Bid/Ask Relief

Bid/Ask Circular BA06-43 regarding modified bid/ask differentials for OEX will no longer apply. Relief as stated in BA08-73 allowing double wide relief on the opening will be applicable.

V. Firm Quote Obligations

MM's individual quotes (electronic and open outcry) are firm quotes and must be honored in accordance with CBOE's Firm Quote Rule 8.51. This is different from non-Hybrid classes in which the crowd shares the responsibility for the electronic quote.

VI. "Quote Aping" and Anticompetitive Conduct

In the Hybrid Approval Order, the SEC stated:

> Although it is not unlawful for a market maker to take the prices offered by its competitors into account when setting its own prices, or to follow or copy prices of its competitors, such a decision must be a unilateral business judgment not intended to harass or punish a competitor for improving prices or otherwise acting competitively and not the result of collusive agreement. Accordingly, the Commission expects that the CBOE will surveil its market to ensure that market makers are not coordinating quotes in the Hybrid system or engaging in other anticompetitive conduct.

The Exchange will surveil for such conduct.

Any questions regarding quoting obligations should be addressed to Daniel Hustad at (312) 786-7715 or Patrick Sexton at (312) 786-7467. If you have any questions regarding the Hybrid dials, please contact Anthony Montesano (montesan@cboe.com), or the Help Desk at 1-866-728-2263.

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[1] The maximum spread widths for intra-day electronic quoting is generally the greater of $5 or, for at- and in-the-money series, as wide as the underlying primary market (or quote width calculated by the Exchange or its agent for various indices). The maximum spread widths for opening rotations and intra-day open outcry trading is generally as follows: $0.25 for options under $2, $0.40 for options above $2 but not over $5, $0.50 for options above $5 but not over $10; $0.80 for options above $10 but not over $20; and $1 for options above $20. However, please see discussion above regarding bid/ask relief.