# CBOE Regulatory Circular RG13-112
# CFE Regulatory Circular RG13-026

**Date: August 15, 2013**

**To:** CBOE Trading Permit Holders and CFE Trading Privilege Holders
**From:** Regulatory Services Division
**RE:** Further Follow-Up to Trading Permit Holder and Trading Privilege Holder Educational Session on CFE Exchange of Contract for Related Position Transactions

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On July 31, 2013, an educational session was held that addressed the requirements for Exchange of Contract for Related Position (ECRP) transactions under CFE Rule 414. ECRP transactions involving CFE and CBOE products are permitted; however, trading on CBOE is subject to CBOE Rules and no special treatment is given under CBOE Rules to the fact that the CBOE leg is part of a CFE ECRP transaction.[1] The slides that were presented during that session are available at: http://cfe.cboe.com/aboutcfe/legal/rules.aspx.

On August 1, 2013, the Exchanges issued a joint follow-up circular, a copy of which is available at: http://cfe.cboe.com, and a follow-up session was held in the VIX trading crowd to further discuss questions that had been received.

A question that arose during the follow-up session related to delta neutral tied trades involving VIX futures (traded on CFE) and VIX options (traded on CBOE). A delta neutral transaction involving VIX futures and VIX options may qualify as an ECRP if (i) there is high degree of price correlation between the components so that the futures component of the transaction would serve as an appropriate hedge for the options component, (ii) there is quantitative equivalence between the futures and options components and (iii) all other requirements of an ECRP are met. Parties are expected to be able to reasonably demonstrate that the transaction was delta neutral and satisfies the ECRP requirements. As a general rule, parties should be able to demonstrate (or replicate) whatever calculation was made with regard to correlation at the time of the ECRP transaction, including maintaining and producing any records regarding the delta or vega utilized.

## Examples of Transactions that Would Qualify as an ECRP Under CFE Rule 414:[2]

**Example #1**: Long 1,000 VIX September 15 calls @ $1.45 tied delta-neutral to VX September futures @ 15.00. At the time of the trade, the Unit Delta[3] of the call option is 54.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Buy | 1,000 | VIX September 15 Calls | 54 | 54,000 |

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[1] Slides 15 and 16 that were presented during the session set forth the CBOE Rules that are applicable to execution of a Related Position of an ECRP in a CBOE product.

[2] The examples set forth in this section of the circular assume that all of the other required elements of an ECRP have been satisfied. CFE Trading Privilege Holders should refer to CFE Rule 414 for additional detail. Also, these examples illustrate one party to the ECRP transaction. The opposing side of these examples would be taken by the other party or parties to the ECRP.

[3] "Unit Delta" refers to the delta of 1 contract. The delta of a VIX option can range from 0 to 100. For the purposes of this circular, the delta of a VIX option is determined relative to the price of the corresponding VX futures contract (e.g., the delta for September VIX options would be determined relative to September VX futures prices). Since VX futures are 10 times the notional size of VIX options, VX futures have a delta of 1,000.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Sell | 54 | VX September Futures | 1,000 | -54,000 |

***NET DELTA*** ***0***

In this example, the long option delta offsets delta of the short futures position, and would be considered delta-neutral. As such, this trade would qualify as an ECRP.

**Example #2**: Long 3,000 VIX October 25 calls @ $0.65 and long 3,000 VIX October 30 calls @ $0.25 (i.e., "call stupid"), tied to 100 VX October futures @ 16.00. At the time of the transaction, the Unit Deltas of the call options are 20 and 13, respectively.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Buy | 3,000 | VIX October 25 Calls | 20 | 60,000 |
| Buy | 3,000 | VIX October 30 Calls | 13 | 39,000 |
| Sell | 100 | VX October Futures | 1,000 | -100,000 |

***NET DELTA*** ***-1,000***

In this example, the aggregate delta of the 2 call options is closely offset by the delta of the short futures position. As such, this trade would be considered delta-neutral and would qualify as an ECRP.

**Example #3:** Short 1,500 VIX October 25 calls @ $0.65and short 1,500 VIX October 13 puts @ $0.25 (i.e., "strangle"), tied to VX October futures @ 16.00. At the time of the transaction, the Unit Deltas of the call and put options are 20 and -14, respectively.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Sell | 1,500 | VIX October 25 Calls | 20 | -30,000 |
| Sell | 1,500 | VIX October 13 Puts | -14 | 21,000 |
| Buy | 9 | VX October Futures | 1,000 | 9,000 |

***NET DELTA*** ***0***

In this example, the aggregate delta of the option strangle is offset by the delta of the long futures position. As such, this trade would be considered delta-neutral and would qualify as an ECRP.

**Examples of Transactions that Would Not Qualify as an ECRP Under CFE Rule 414[4]:**

**Example #1:** Short 1,000 VIX September 15 calls @ $1.45 tied one-to-one to VX September futures @ 15.00 (i.e., "covered call" or "buy write"). At the time of the trade, the Unit Delta of the call option is 54.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Sell | 1,000 | VIX September 15 Calls | 54 | -54,000 |
| Buy | 100 | VX September Futures | 1,000 | 100,000 |

***NET DELTA*** ***46,000***

In this example, the short option delta does not offset the delta of the long futures position, and would not be considered delta-neutral. As such, this transaction would not qualify as an ECRP.

**Example #2:** Long 3,000 VIX October 16 puts @ $1.90 tied one-to-one to VX October futures @ 16.00 (i.e., "married put"). At the time of the transaction, the Unit Delta of the put option is -45.

[4] The hypothetical transactions set forth in the examples in this section to the circular would not qualify as an ECRP, even if all of the other required elements of an ECRP have been satisfied, and could be subject to disciplinary action.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Buy | 3,000 | VIX October 16 Puts | -45 | -135,000 |
| Buy | 300 | VX October Futures | 1,000 | 300,000 |
| | | | ***NET DELTA*** | ***165,000*** |

In this example, the short option delta does not offset the delta of the long futures position, and would not be considered delta-neutral. As such, this trade would not qualify as an ECRP.

**Example #3:** Short 2,000 VIX October 19 calls @ $1.25 and long 2,000 VIX October 13 puts @ $0.25, tied to 200 VX October futures @ 16.00 (often referred to as a "risk reversal"). At the time of the trade, the Unit Deltas of the call and put options are 36 and -14 respectively.

| Buy/Sell | Quantity | Position | Unit Delta | Total Delta |
|---|---|---|---|---|
| Sell | 2,000 | VIX October 19 Calls | 36 | -72,000 |
| Buy | 2,000 | VIX October 13 Puts | -14 | -28,000 |
| Buy | 200 | VX October Futures | 1,000 | 200,000 |
| | | | ***NET DELTA*** | ***100,000*** |

In this example, the aggregate delta of the short call/long put position does not offset the delta of the long futures position. As such, this trade would not be considered delta-neutral and would not qualify as an ECRP.

### Additional Information:

Subsequent questions may be directed to the Regulatory Services Division's Interpretation and Guidance Team by phone at (312) 786-8141 or by e-mail to RegInterps@cboe.com.