



Regulatory Circular RG02-111

To: Members and Member Firms

From: Department of Market Regulation

Date: December 11, 2002

Re: Chicago Board Options Exchange's Commencement of Quote Width Surveillance.

The Chicago Board Options Exchange's (the "Exchange") Department of Market Regulation (the "Department") has discussed with the Securities and Exchange Commission the development and implementation of an automated surveillance system for market quotes that exceed the parameters of Exchange Rule 8.7.

The Exchange has developed and implemented an automated program to detect Illegal Quote Widths ("IQW"). The program takes into account the bid/ask differentials in Exchange Rule 8.7:

- 0.25 where the Bid is less than or equal to \$1.99
- 0.40 where the Bid is \$2.00 to \$5.00
- 0.50 where the Bid is \$5.01 to \$10.00
- 0.80 where the Bid is \$10.01 to \$20.00
- 1.00 where the Bid is 20.01 and above

and whether bid/ask relief has been granted by the Market Performance Committee ("MPC") or Floor Officials. If the series is "in the money", the program takes into consideration the stock bid/ask differential in the primary market.

The staff has noted the following factors that would affect the disseminated quotes:

- Incorrect bid/ask differential parameters in proprietary autoquote systems. For example, if a DPM were to set its bid/ask parameter for .50 with respect to bids from 5.00 - 9.99, instead of using that parameter only for bids from 5.01 to 10.00, this would result in improperly wide quotes on a bid of 5 dollars.
- Expiration of bid/ask relief granted by the Exchange's Market Performance Committee ("MPC"). MPC relief is granted for a pre-determined period, most typically the current expiration cycle. After expiration or other pre-determined period, the MPC bid/ask relief expires. DPMs requesting relief must, prior to the end of the cycle, either request and receive confirmation of continued relief from MPC or reset their bid/ask parameters to correspond to Exchange Rule 8.7.

- Widening quotes past permissible bid/ask parameters prior to requesting bid/ask relief from MPC or exceeding the relief parameters granted by MPC. It is also impermissible to widen autoquote parameters prior to being granted either Floor Official or MPC relief.
- Receiving temporary intra-day bid/ask relief from Floor Officials, and not resetting the bid/ask parameters the next day. Intra-day bid/ask relief granted by Floor Officials is only valid for the day granted and, unlike MPC relief, not for the expiration cycle. If the DPM requires bid/ask relief the following day, the DPM must again request it the subsequent day. If the DPM anticipates requiring bid/ask relief for an extended period, MPC is the approving authority for the relief.
- Application of Exchange Rule 8.7 to LEAPS. Rule 8.7 applies when LEAPS are within nine months of expiration, at which time they are allowed doublewide bid/ask differentials at the direction of MPC. Subsequent to the nine month window when doublewide bid/ask differentials apply, and dependant on the option cycle, LEAPS convert to a normal option symbol. When LEAPS convert to a normal symbol the doublewide bid/ask differentials are no longer applicable. DPMs must take precautions to not overlook the conversion date, or the resultant bid/ask differentials may be impermissibly wide.
- For those DPMs using a proprietary autoquote system that allows “snapping” markets to refresh the quotes, snapping at or more than 100%, where no bid/ask relief has been granted, may cause the system to temporarily disseminate a market that exceeds the allowable width. Members operating autoquotes that allow snapping should implement policies or procedures to ensure appropriate use of the feature.
- Setting autoquote to recognize a market other than the designated primary market may cause the differential for in-the-money options series to be wider than permitted. Rule 8.7 specifies that the market in these options series can be as wide as the market quote on the **primary** market of the underlying security.

Please review your current policies and procedures for setting your autoquote parameters to ensure you are in compliance with Exchange Rule 8.7. Violation of the market width provisions of Exchange Rule 8.7 may result in summary fines pursuant to Exchange Rule 17.50 or regulatory action by the Exchange’s Business Conduct Committee.

Questions regarding MPC relief should be directed to Angela Redell, in the Exchange’s Market Quality Assurance Department at (312) 786-7559.

Questions about obtaining intra-day relief by Floor Officials should be directed to the Help Desk at (312) 786-7100

Questions or concerns about the Illegal Quote Width surveillance program should be directed to Michael Felty in the Exchange’s Department of Market Regulation at (312) 786-7504.