



Regulatory Circular RG05-38

To: Membership
From: Trading Operations, Regulatory Services Division and Legal Division
Date: April 14, 2005
Re: Minimum Quote Size and Maximum Quote Width in Hybrid Classes

Minimum Quote Size

Initial market-maker quote size in Hybrid classes must be for at least 10-contracts, whether the quote is provided in open outcry or electronically. Once the size decrements to zero, the market-maker must replenish to at least 10-contracts, except as specified below.

Effective in August 2004, in Hybrid classes, market-makers, DPMs, and e-DPMs (*i.e.* "MM") were given the ability to post a 1-up size on the appropriate side of the underlying option quote when the quote size on the primary underlying market is 1-up (*i.e.*, 100 shares).¹ This process must be automated (*i.e.*, no manual adjustments). This means that when the primary market increases its quote size from 1-up, CBOE MM quote size must automatically (not manually) increase to the minimum requirement of 10-up.

Examples:

NYSE quote size in ABC stock is 1x1:	CBOE MMs' minimum quote size requirement is 1x1 for calls and puts.
NYSE quote size in ABC stock is 1x7:	CBOE MMs' minimum quote size requirement is 1x10 for calls and 10x1 for puts.
NYSE quote size in ABC stock is 20x1:	CBOE MMs' minimum quote size requirement is 10x1 for calls and 1x10 for puts.

Prerequisite to Quoting 1-up

Prior to being able to participate in this pilot program, MMs or their vendors that provide their handheld quoting devices must demonstrate to the Exchange that they have automated the process. Members should have their vendors contact Trading Operations (via the Help Desk at 7100) to certify that their systems are compliant. Members that provide 1-up quoting without certification by themselves or their vendors are in violation of Exchange rules and subject to disciplinary action.

Open Outcry RFQs:

Market-makers **MUST** respond to all verbal RFQs with a legal-width, 10-up market for customers and 1-up for BDs

Quote Widths:

Electronic quotes **MUST** be no wider than legal-width. In Hybrid classes, electronic quotes are permitted to be \$5 wide following the opening rotation in each security². Opening rotation and

¹ The ability to quote 1-up in Hybrid was approved as a one-year pilot period set to expire August 17, 2005.

² The maximum permissible spread widths applicable to non-Hybrid classes as well as to Hybrid classes during rotations and in open outcry are as follows: \$0.25 for options under \$2, \$0.40 for options above \$2 but not over

open outcry quotes in Hybrid classes must comply with the same maximum permissible widths as non-Hybrid classes.

“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.

Contacts:

Questions regarding the certification process for quoting 1-up, should be addressed to Anthony Montesano at (312)786-7365 or Greg Burkhardt at (312)786-7531 in Trading Operations, or Tim MacDonald in Market Regulation at (312) 786-7706. For questions regarding application of the rules, please contact Andrew Spiwak at (312) 786-7483 or Tim MacDonald at (312) 786-7706.