

Date: October 17, 1995
To: Members and Member Organizations
From: Operations Planning Division
Re: Trading in Securities Subject to Chapter 30 Rules

The Exchange anticipates that it will begin trading additional securities listed pursuant to Chapter 30 of the Exchange rules. The following is a summary of previously issued Regulatory Circulars concerning trading in such securities. Chapter 30 rules are applicable only to the trading of stock, warrants, UIT interests and other such securities as the Board of Directors may declare subject to those Rules. Options are not subject to the Chapter 30 rules. The only securities currently traded at CBOE under Chapter 30 rules are the SuperShare products. Generally, Exchange rules in Chapters 1 through 19 are also applicable to securities subject to Chapter 30. However, in some instances, Chapter 30 rules supplement particular rules in Chapters 1 through 19. In other cases, Chapter 30 rules replace rules in Chapters 1 through 19. Members are encouraged to read the full text of Chapter 30 and previously issued regulatory circulars to understand the full meaning of the rules and where those rules may supplement or replace other Exchange rules.

Member Qualification to Trade Chapter 30 Securities

Individual Members

Floor members are required to register with the Exchange's Membership Department before entering into any transactions in securities traded pursuant to Chapter 30. Floor members are required to sign an Application and Affidavit form stating that they have received, read and understand the rules applicable to trading Chapter 30 securities. Market Makers and DPMs are required to submit to the Membership Department a separate Letter of Guarantee for Chapter 30 securities. Floor Brokers are required to submit a separate Letter of Clearing Authorization for Chapter 30 securities. Upon completing these requirements, a sticker will be affixed to the member's trading badge affirming that he or she is qualified to trade in Chapter 30 securities. (See Rules 6.72, 8.5 and 30.2 and Regulatory Circulars RG90-62 and RG 90-63)

Member Organizations

Member organizations must be members of the National Securities Clearing Corporation (NSCC) and/or the Midwest Clearing Corporation (MCC) to be eligible to clear trades in securities traded pursuant to Chapter 30. Member organizations which are not members of NSCC or MCC must make arrangements with a clearing member if they intend to conduct business in Chapter 30 securities. All member organizations that intend to clear Chapter 30 securities must advise the Market Operations Department, in writing, prior to the beginning of trading in the securities that it intends to clear. (See Regulatory Circular RG90-54 and Rule 30.90)

Rules of Trading Procedure

Quotations

The Exchange is required to provide the best bid, the best offer and the size of the best bid and best offer to the Consolidated Quotation System (CQS). The DPM or OBO will be responsible for collecting and aggregating the size of the best bid and best offer for dissemination. The disseminated best bid and best offer is firm for the displayed size unless the market has been withdrawn, executed or an exemption existed pursuant to the provisions set forth in CBOE Rule 30.11(e). The two exemptions to the firm quote rule are 1) a revised bid, offer or size was communicated into the quotation system but not yet disseminated, or 2) the bid or offer that was disseminated was executed prior to the arrival of the order seeking an execution at the disseminated bid or offer. Also, a non-firm quote condition may be declared by two Floor Officials if market conditions warrant such action. (See Rule 30.11 and Regulatory Circular RG91-01)

Under normal circumstances, if a bid is disseminated which is equal to or above another marketplace's offer (or an offer is disseminated which is equal to or below another marketplace's bid) and a complaint is received while the market is still locked or crossed, the complaining marketplace must be satisfied by trading with the complaining party through the ITS System (if requested by the complaining marketplace) or by unlocking the market. (See Rule 30.76(d))

Priority and Parity at the Opening and Reopening

Priority and Parity for Market Orders

At the opening, market orders (including orders held by the DPM or OBO in the book and orders held by Floor Brokers in the crowd) have precedence over limit orders and are to be executed at one price unless a Floor Official authorizes otherwise. Limit orders to buy at a price higher than the opening price and to sell at lower than the opening price are to be treated as market orders. Market orders to sell short are to be treated as limit orders to sell at the next permissible short sale price. (See Rule 30.14 and Regulatory Circular RG91-04)

Priority and Parity for Limit Orders

Orders with limits equal to the opening price are not to be treated as market orders at the opening. Orders with limits equal to the opening price which are held by Floor Brokers are on parity with limit orders held by the DPM/OBO as long as the limit order held by the Floor Broker is not an opening order for a Market Maker/DPM account. After all market orders (including marketable limit orders as described above) have been paired off, the net imbalance is to be executed at the opening price against all other orders which are on parity. (See Rule 30.14 and Regulatory Circular RG91-04)

Book Participation Right on the Opening

The DPM/OBO, as agent on behalf of limit orders which he holds, is entitled to participate on the opening at a higher rate against the net imbalance. The number of Floor Brokers in the crowd that are also representing limit orders at the opening price is the factor which determines the participation rate by the DPM/OBO. If there is only one Floor Broker on parity, orders held by the DPM/OBO are entitled to 60% of the imbalance; if two to five Floor Brokers are on parity, orders held by the DPM/OBO are entitled to 40%; if there are six or more Floor Brokers on parity, orders held by the DPM/OBO are entitled to 30%. (See Rule 30.14 and Regulatory Circular RG91-04)

Priority and Precedence of Bids and Offers After the Opening

After the opening, orders maintained in the book by the DPM or OBO compete equally with bids and offers in the trading crowd. If the particular Chapter 30 security is not assigned to a DPM, the following priorities apply. The highest bid and lowest offer has precedence in all cases. Where multiple bids at the highest bid or offers at the lowest offer are made, the member who is first to announce the highest bid or lowest offer has priority on the next transaction to trade up to the number of units specified in his or her bid or offer. If no determination can be made as to which of several highest bids or lowest offers were first, all such highest bids or lowest offers are on parity and are entitled to participate on a proportionate basis until such bids or offers to the announced size have been satisfied or until a higher bid or lower offer has been announced. After a transaction has occurred, all bids and offers are removed from the floor and must be reestablished by open outcry. If the particular Chapter 30 security is assigned to a DPM, the priorities described above apply with the following exception: where the DPM's principal bid (offer) is equal to the highest bid (lowest offer), the DPM is entitled to participate in a transaction at that price to the extent provided by Rule 8.80(c)(7)(ii) and MTS Committee policy related thereto, notwithstanding anything in Rule 30.13 to the contrary. (See Rule 8.80 and 30.13 and Regulatory Circular RG91-04)

Crossing Orders

A member representing orders to buy and sell at the same price may execute the orders with each other if, after requesting a market in the security, the member bids above the highest bid and offers below the lowest offer and announces the cross transaction. (See Rule 30.13 and Regulatory Circular RG91-04)

Intermarket Trading System (ITS)

Securities traded pursuant to Chapter 30 rules which are traded on more than one exchange will be subject to the requirements of the Intermarket Trading System (ITS) Plan. The ITS Plan is a set of rules intended to assure that transactions in a particular security that is traded in two or more marketplaces take place in one marketplace at prices that are not in conflict with the markets being displayed by other marketplaces trading the same security. The ITS System is an electronic communication and order routing system which facilitates communication and the routing of orders (called "commitments to trade") between the exchanges trading the particular Chapter 30 securities.

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Pre-Opening Application Rule

If the DPM or OBO anticipates that an ITS eligible security will open at a price which is

different from the previous day's consolidated closing price by more than the amount specified in the

rule the DPM or OBO

is required to issue a pre-opening notification to the other marketplace which trade that particular security.

The anticipated price

change that requires the issuance of a pre-opening notification is different, depending upon the last sale price and whether it

is a tape A or tape B security.

The applicable price changes are as follows:

<u>Security</u>	<u>Consolidated Closing Price</u>	<u>Applicable Price Change (More Than)</u>
Network A Listed Security (NYSE Listed Security)	Under \$15	1/8 point
	\$15 or over	1/4 point
Network B Listed Security (Not NYSE Listed Security)	Under \$5	1/8 point
	\$5 or over	1/4 point

After issuing the pre-opening notification, the DPM/OBO is required to wait not less than three minutes before opening the security which was the subject of the pre-opening notification. The pre-opening notification is required to contain specific information, including the “IND” pre-opening indication designator, Exchange identifier, DPM/OBO identification and the applicable price range. The width of the applicable price range is limited as follows:

<u>Security</u>	<u>Consolidated Closing Price</u>	<u>Maximum Allowable Range</u>
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Network A Listed Security (NYSE Listed Security)	Under \$50 \$50 or over	½ point 1 point
Network B Listed Security (Not NYSE Listed Security)	Under \$10 \$10 or over	½ point 1 point

Responses to pre-opening indications which are sent through the ITS System and are marked “agency” are treated like any other agency order by the DPM or OBO. If the pre-opening response is marked “principal” (or not marked agency or principal), the response is not entitled to participate in the imbalance to a greater extent than a CBOE DPM or market maker. Following the execution of a pre-opening response, the DPM or OBO is required to send a prompt report of execution to the exchange that sent the pre-opening response. (See Rule 30.72 and Regulatory Circular RG90-64)

The Trade-Through Rule

Members in one marketplace are to avoid trading through the displayed market of another marketplace. Should a trade-through occur, it is incumbent upon the member whose market

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was traded through to file a complaint with the marketplace that initiated the trade-through within 5 minutes of the print. The member who initiated the trade-through is required to either satisfy the marketplace that was traded through for the displayed size at the price of the bid or offer that was traded through, or correct the price of the trade to a price that would not cause a trade-through. If the trade that caused the trade-through is between two market makers or between a market maker and a DPM, the trade must be broken and canceled from the tape. A member in a marketplace may cross a block (currently defined as a “cross” involving 10,000 units or \$200,000 in value) at a price outside the national best bid/offer as long as the member simultaneously satisfies all superior displayed bids/offers at the block price. A block size trade which results from the execution of a buy or sell order against resting bids or offers is a “one-sided block trade” and a trade-through involving a one-sided block trade entitles the violated marketplace(s) to satisfaction at the displayed bid or offer that was traded through (not at the price of the block trade). (See Rule 30.76 and Regulatory Circular RG90-64)

Short Sales

Marking Sell Orders and the Tick Test Requirements

All orders to sell Chapter 30 securities must be marked “long” or “short”. Except for DPMs or Market Makers holding appointments in particular Chapter 30 securities, no member or member organization may effect a short sale on the CBOE at 1) a price below the last sale at which the security traded on the CBOE (a “minus tick”), or 2) a price which is below that last different price that the security traded on the CBOE (a “zero minus tick”). Assigned DPMs and Market Makers holding appointments in a particular security may sell short at a price equal to the last reported sale on the consolidated reporting system (regardless of the CBOE last sale price). In addition, assigned DPMs and Market Makers may offer short at a price equal to the last reported sale on the

consolidated reporting system and a short sale may be effected at that offering price irrespective of the last sale on the consolidated reporting system. The SuperShares products are exempt from the “tick test” provisions of the short sale rule. (See Rule 30.20 and Regulatory Circular RG91-35)

Borrowing Requirements and Buy-ins

As in the case of short sales involving stock, members effecting short sales of Chapter 30 securities for customers or their proprietary accounts must make prior arrangements to borrow the securities or have other assurances that the delivery can be made on the settlement date. Market Makers and DPMs are exempt from this requirement for transactions related to their market making responsibilities. Although exempt from the prior borrowing requirement, Market Makers and DPMs should be aware that a failure to deliver the securities sold short on the settlement date may result in a buy-in being executed. Even in situations where the securities are borrowed and the delivery obligation is met, the lending broker-dealer has the right to demand that the securities be returned. Failure to do so may result in a buy-in. In either case, short sellers may be closed out of their position at a time and/or price which exposes them to unexpected losses. Members should discuss with their clearing firm the particular risks associated with short sales of Chapter 30 securities.

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Post-Trade Processing

Trades executed in Chapter 30 securities which involve the DPM, or where one or both sides of the transaction involve an order which was entered in the Exchange’s trading system, will be immediately entered into the Exchange’s systems as a “locked” trade for clearing purposes. Where a trade occurs between members of the crowd, each side of the trade must immediately submit their side of the trade to a designated person at the trading station who will input the trade for clearing. All trades in Chapter 30 securities will be submitted to the National Securities Clearing Corporation (NSCC) for clearance, unless CBOE Market Operations is notified otherwise. Trades will be submitted to NSCC in the name of the executing parties. In order to accommodate transactions executed on behalf of correspondent clearing firms, information relating to correspondent relationships must be sent directly to NSCC by the executing firm.

End of day reports and electronic data detailing the day’s activity will be provided by 4:00 p.m. Chicago time. This information is intended to assist firms in the review and balancing of transactions in Chapter 30 securities. Activity in any such securities executed on the CBOE will also appear on the Regional Interface Operations (RIO) Report which is published by NSCC. In the event of clearing error, CBOE Market Operations staff will, upon notification and verification of the correct trade information, provide corrections to NSCC. (See Rule 6.61)

Margin Treatment

Market Makers and DPMs will be subject to good faith margin treatment on positions in Chapter 30 securities which result from their transactions as market makers. Determinations as to whether permitted offset treatment will be allowed on other securities used as a hedge will be made on a case by case basis, subject to approval by the staffs of the Board of Governors of the Federal Reserve

System and the Securities and Exchange Commission. (See Rules 12.1 and 30.41 and Regulatory Circular RG91-07)

Margin treatment on customer positions will be based on the nature of the particular Chapter 30 security. In general, warrant products will be margined as options, with the margin level determined by the volatility of the underlying instrument. The specific customer margin requirements for each Chapter 30 security will be described in a regulatory circular to be issued prior to the beginning of trading in the particular security. (See Rule 30.52 and Regulatory Circular RG95-78)

Net Capital Treatment

Net capital treatment for Chapter 30 securities will be based on the risk characteristics of the particular security. In general, warrant products will be haircut as options, with the coverage determined by the volatility of the underlying instrument. The capital treatment for Chapter 30 securities will be described in a regulatory circular to be issued prior to the beginning of trading in the particular security.

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Sales Practice and Suitability Requirements

The specific sales practice and suitability requirements for Chapter 30 securities may differ from one product to another depending upon the characteristics of the product. With respect to stock index and currency index warrants and warrants on individual currencies, it has been determined that transactions in such warrants may be effected only in accounts which have been approved for options trading. Additionally, customers should be advised of the special characteristics of warrants.

Before recommending a transaction in warrants, a determination must be made that the warrants are not unsuitable for the customer. The sales practice and suitability requirements for other Chapter 30 securities will be described in a regulatory circular to be issued prior to the beginning of trading in the particular security. (See Rules 9.7, 9.8, 9.9, 9.10, 9.21, 30.50 and 30.52 and Regulatory Circular RG95-78)

Position and Exercise Limits

Position and exercise limits will apply to certain Chapter 30 securities. With respect to stock index warrants, CBOE Rule 30.35 sets forth the particular position and exercise limits for that product type. The applicability of position and exercise limits for other Chapter 30 securities will be described in a regulatory circular to be issued prior to the beginning of trading in the particular security. (See Rule 30.35)

Staff Contacts

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(Regulatory Circular RG95-26 Reissued)