



Information Circular IC10-96

Date: April 23, 2010

To: CBOE Members

From: Office of the Chairman

Re: SEC Proposed Implementation of a Fee Cap in Listed Options

This memo seeks to apprise members of a recent regulatory development in the listed options market, which also relates to CBOE's S-4 registration document. The Securities and Exchange Commission (SEC) recently published for comment a proposed amendment to Rule 610 of Regulation NMS that would, among other things, establish a \$0.30 per contract limit on the amount a national securities exchange would be permitted to charge to access the best bid or offer for listed options on its exchange.

In the 94-page proposal, the SEC affirms its belief that intermarket price protection is essential in a marketplace where multiple exchanges trade the same security, and raises its concern that “the benefits of intermarket price protection could be compromised if exchanges were able to charge substantial fees for accessing their quotations.” Additionally, the SEC notes that “[t]he wider the disparity in the level of fees among the different exchanges, the less useful and accurate are the displayed prices.” Therefore, the SEC proposes a \$0.30 per contract cap on the “all-in” cost to access quotations that represent the best bid or offer on an options exchange. As proposed, the fee cap would not just cover taker and transaction fees, but would also include, among other fees, licensing and regulatory fees.

Despite the fact that the SEC’s intermarket access concerns do not apply to single-list products, the SEC states (in question 17 of the Request for Comment Section of the release) that “as proposed, the fee limitation...would apply to fees charged for executions of orders in all listed options, including those that are listed and traded only on one options exchange.” Unfortunately, the SEC does not discuss single-list products at all in the proposal beyond that short one-paragraph question, nor does it offer any justification in the release as to why single-list products are proposed to be subject to the fee cap. Further, while the proposed rule text is drafted broadly, our interpretation of the discussion in the release is that the proposed rule is intended to apply to fees associated with accessing an exchange’s displayed bid or offer. For example, the SEC states in the release that “the proposed access fee...would apply only to quotations that market participants are required to access to comply with the Trade-Through Rule...” Such statements support not only excluding single-list products from the proposed fee cap, but also all instances involving orders *not* seeking to access the displayed quotation of an options exchange such as orders traded in open-outcry, orders processed through electronic price improvement auctions, and cross transactions.

The SEC release completely ignores the difference in notional value between single-list index products like SPX and multiple-list ETF options based on similar indexes -- the proposal would institute a one-size-fits-all fee level. Further, and contrary to its stated intention to avoid placing undue burdens on an exchange, the proposal calls into question why an exchange such as CBOE would engage in costly research and development efforts to produce innovative financial products when the free market is prohibited from dictating pricing for such products.

CBOE will be submitting formal comment on the proposal in the coming weeks. In the meantime, SEC disclosure requirements require the Exchange to disclose known risk factors pertaining to our business in general. Accordingly, the Exchange is modifying CBOE Holdings, Inc.'s Form S-4 Registration Statement to reflect that the SEC has proposed an options fee cap and has estimated potential revenue reductions to CBOE as a result of the fee cap. Based on December 2009 trade data available to the SEC, the SEC estimates a potential reduction in annual revenue to CBOE of \$23.9 million assuming the fee cap is adopted as proposed. We do not have complete information on how the SEC arrived at this figure, but it appears that the SEC included transactions that in no way involved orders accessing the Exchange's displayed quotation. Such transactions constitute a meaningful percentage of contracts traded on CBOE. We were gravely disappointed that the SEC would issue a release forecasting revenue losses without detailing the exact methodology employed and without seemingly refining the analysis to correspond to the SEC's own rationale for its proposal.

Nothing in the SEC's stated intent for the proposed fee cap supports the application of a cap to single-list products, open outcry trading, or the plethora of electronic crossing and price improvement auctions that are employed by multiple exchanges and are unique to the options market. We will work diligently in the coming weeks to prepare our formal comment, which will vigorously challenge the soundness of the SEC's one-size-fits-all approach to fee caps.