



DRAFT DATE: October 4, 2002

TO: All Exchange Members

FROM: Department of Market Regulation

RE: Position Limit Violations

The purpose of this circular is to advise members of the provisions of Exchange Rule 17.50, Imposition of Fines for Minor Rule Violations, as they relate to position limit violations. Rule 17.50 enables the Exchange staff to process certain minor rule violations, including position limit violations, on an expedited basis in lieu of commencing a disciplinary proceeding provided that the fine imposed for any such violation(s) does not exceed **\$5,000.00**. Additionally, members have the opportunity to submit **one written offer of settlement** to the Exchange's Business Conduct Committee ("BCC") for position limit violations processed under Rule 17.50, which **a) result in any one-day fine in excess of \$2,500, but not greater than \$5,000 or b) continue over five or more consecutive trade dates with an aggregate fine greater than \$10,000, and not more than \$5,000 on any day**. Such settlement offer must be submitted **within thirty (30) days** of the date of service of the written statement informing the member of the fine(s) imposed and a member may personally appear once before the BCC to make an oral statement in support of the offer. More specifically, Rule 17.50(g)(1) provides for the imposition of the following fines for violations of Exchange Rule 4.11, which governs position limits.¹

Number of Cumulative Violations In Any Twelve (12) Month Period

Fine Amount	Accounts of Non-Member Customers²	All Other Accounts
Letter of Caution, up to 5% in excess of the applicable limit; above that level, \$1 per contract	1 – 6	1 – 3*
\$1 per contract over limit	7 - 12	4 - 6
\$2.50 per contract over limit	N/A	7 - 9
\$5 per contract over limit	13+	10+

* For the first three (3) violations within any rolling twelve (12) month period, a two (2) consecutive trade date overage will be counted as a single violation. Additionally, Exchange staff, at its discretion, may conduct a staff interview with a member for the third violation in lieu of issuing a Letter of Caution.

Fines imposed for position limit violations under Rule 17.50 (g) (1) shall be in the minimum amount of \$100.

¹ Although Rule 17.50(g)(1) does not specifically reference all of the Exchange's rules which govern position limits, all position limit violations under the Exchange rules (no matter what type of option they relate to) are deemed to be violations of Rule 4.11 and thus are subject to fine under Rule 17.50(g)(1).

² For purpose of this rule, all accounts of non-member broker-dealers will be treated as non-member customer accounts, and for each CBOE member, all violations occurring in such accounts will be tallied cumulatively.

The Exchange has adopted the following policy guidelines in connection with the application of Rule 17.50(g)(1):

(1) *Transaction Calculations.* In calculating the number of position limit violations within a rolling twelve (12) month period, the Exchange will count each day in which a position limit is exceeded as a separate violation, with the exception noted in the chart on the preceding page for violations 1-3 in the account of a member.

(2) *Joint Accounts.* In the event that trading in a joint account exceeds the position limits, only those participants in the joint account who traded on the day of the violation will be subject to sanction. A potential fine will be calculated with respect to each participant who traded on the day of the violation, and a single fine will be imposed which is equal to the highest potential individual fine. Participants who traded will be jointly and severally liable to the extent of what the fine would have been based on their individual history. If a nominee of a firm is involved, the firm and the individual will be jointly and severally liable, and the firm's history will not be taken into account in computing the fine.

(3) *Exemptions.* If an individual has a higher limit due to an exemption, and violates that limit, the fine will be calculated with reference to the higher limit. With respect to the first three (3) violations, however, any fine will be computed on the basis of 5% of the regular position limit, rather than the individual's higher limit.

(4) *Two-Sided Violations.* If a member exceeds the position limit due to both (a) a long call and short put position and (b) a short call and long put position, the fine will be computed based on the total contract overage after combining both sides, but will be considered only one occurrence.

(5) *Broad-Based Index Violations.* Any member who violates both the overall limit and the near term limit contained in Rule 24.4 will be fined only on the basis of the larger violation. For example, a member holding 27,000 contracts on the same side of the market, 15,500 of which have the nearest expiration date, will be fined only on the basis of the 2,000 contracts in excess of the overall limit, and not on the basis of the 500 contracts in excess of the near term limit.

(6) *Pre-Notification.* The Department of Market Regulation shall endeavor to provide pre-notification to all members whose positions are within 10% of the applicable position limit of a specific option class. The Department of Market Regulation shall endeavor to deliver such notice on the business day following detection that a position is within 10% of the applicable position limit.

(7) *Preliminary Notification.* The Department of Market Regulation shall endeavor to notify all members who appear to have violated the position limits. The Department of Market Regulation shall endeavor to deliver such notice on the business day following detection of the violation, and will not take into account out-trades or stock hedges, which could potentially negate the apparent violation.

(8) *Official Notification.* The official notice of the imposition of the summary fine will be contained in the written statement issued by the Exchange pursuant to Rule 17.50(b). Regardless of whether the Exchange has failed to issue the pre-notification and/or preliminary notice pursuant to paragraph (6) above, service of the written statement shall constitute official notice of the fine.

(9) *Reporting Requirements.* Summary fines, which are not in excess of the \$2,500, are reported by the Exchange to the Securities and Exchange Commission on a quarterly basis. Fines above \$2,500 are reported to the SEC on a current basis. Decisions with respect to a written offer of settlement accepted by the BCC will be reported to the SEC on a current basis. Finally, members whose offer of settlement is accepted by the BCC shall also report the acceptance of the settlement offer on the member's broker-dealer ("Form BD") and uniform application for securities industry registration or transfer ("Form U-4") form as a decision in a contested Exchange disciplinary proceeding.

(10) *Right to Contest.* Any person against whom a fine is imposed pursuant to Rule 17.50(g)(1) may contest that fine in accordance with the terms of Rule 17.50(c). Persons wishing to contest such a fine must comply with the deadlines and all

other requirements set forth in Rule 17.50(c).

Any questions in connection with this circular should be directed to Patricia Cerny at (312) 786-7722 or Michael Felty at (312) 786-7504, Department of Market Regulation.

(Regulatory Circulars RG92-15, RG94-60, R95-82; RG97-88 revised)