



Regulatory Circular RG06-124

To: Members

From: Legal Division

Date: December 7, 2006

Re: Penny Pilot Program and Quote Mitigation

As previously announced, the options exchanges intend to commence a Penny Pilot Program on Friday, January 26, 2007, involving 13 option classes. In connection with the Penny Pilot Program, CBOE has filed two proposed rule changes (SR-CBOE-2006-92 and SR-CBOE-2006-98). These rule changes are available on CBOE's website at www.cboe.org/Legal.

Penny Pilot Classes. The following 13 option classes have been selected to participate in the Penny Pilot Program:

| | | | |
|------|---------------------------------|------|---------------------------|
| IWM | Ishares Russell 2000 | INTC | Intel |
| QQQQ | QQQQ | CAT | Caterpillar |
| SMH | SemiConductor Holders | WFMI | Whole Foods |
| GE | General Electric | TXN | Texas Instruments |
| AMD | Advanced Micro Devices | FLEX | Flextronics International |
| MSFT | Microsoft | SUNW | Sun Micro |
| A | Agilent Tech, Inc. ¹ | | |

Minimum Increments. The minimum increments for all classes in the Penny Pilot, except for the QQQQs, will be:

- \$0.01 for all option series below \$3 (including LEAPS)
- \$0.05 for all option series \$3 and above (including LEAPS)
- For QQQQs, the minimum increment will be \$0.01 for all option series. For all other option classes not participating in the Penny Pilot, the current quoting and trading minimum increments will remain the same.

Quote Mitigation Strategies. Due to the anticipated demands on CBOE's system capacity and the option industry's capacity for processing quotations and transactions in penny increments, CBOE has implemented or intends to implement several quote mitigation strategies.

- **Amendment to Market-Maker Obligations.** As described more fully in SR-CBOE-2006-92, CBOE proposes to amend Rule 8.7 to modify the continuous electronic quoting obligation of Market-Makers and Remote Market-Makers ("RMMs"). Currently, as set forth in Rule 8.7(d)(ii) and (e), Market-Makers and RMMs, respectively, are obligated to provide continuous electronic quotes in 60% of the series of his/her appointed option class. **CBOE proposes to amend these obligations to provide that Market-Makers and RMMs shall provide continuous electronic quotes in 60% of the series of his/her appointed class that have a time to expiration of less than nine months.**

¹ Agilent Tech, Inc. was recently selected, and replaces Glamis Gold (GLG) which has been delisted.

- DPMs continue to have an obligation to provide continuous electronic quotes in all of the series of each allocated class.
- e-DPMs, LLMs, and Preferred Market-Makers continue to have an obligation to provide continuous electronic quotes in at least 90% of the series of each allocated class.
- Hybrid Electronic Quoting Fee. As described more fully in SR-CBOE-2006-98, CBOE proposes to establish a new Hybrid Electronic Quoting Fee applicable to all Market-Makers, RMMs, DPMs, e-DPMs, PMMs and LMMs (collectively “Market-Makers”) in order to promote and encourage more efficient quoting. All Market-Makers who are submitting electronic quotations to the Exchange will be assessed a monthly fee of \$450. Each month, each Market-Maker will receive an allocation of 1,000,000 quotes. If a Market-Maker submits to CBOE more than 1,000,000 quotes in a month, the Market-Maker will be assessed an additional fee of \$.03 per 1,000 quotes in excess of 1,000,000. **Note: If a Market-Maker is assessed the Hybrid Electronic Quoting Fee, the Market-Maker does not pay the \$450 member dues fee.** CBOE intends to implement the Hybrid Electronic Quoting Fee effective February 1, 2007. For information regarding individual quote statistics, please contact Charlie Hullihan at (312) 786-7176.
- Delisting Policy. CBOE is adopting the following delisting policy: equity option classes with national average daily volume (“ADV”) of less than 20 contracts will be delisted.
- Limitation on Messages. Pursuant to CBOE Rule 6.23A, CBOE currently limits the number of messages sent by members accessing CBOE electronically in order to protect the integrity of the Hybrid Trading System. Limiting the number of messages sent by members accessing CBOE electronically also reduces the number of quotations sent by CBOE to OPRA. CBOE intends to continue to limit the number of messages sent by members accessing CBOE electronically. For information regarding quote limitations, please contact Anthony Montesano at (312) 786-7365.

Member Testing. CBOE will require vendors and firms with proprietary quote and or order entry interfaces to complete a brief certification process to verify basic messaging in pennies by **January 10, 2007**. This process is not intended to verify all internal processing on the part of the vendor or firm, but rather is intended to verify basic messaging between the firm and the Exchange. The certification will include submission and cancellation of quotes, quote fills and cancel confirmations, submission of orders and order cancels, order fills and cancels confirmations. Certifications should be scheduled through the API Testing Group at (312) 786-7300.

For questions relating to the proposed rule changes, please contact Patrick Sexton, Legal Division, at (312) 786-7467.