

Regulatory Circular RG 99-225

DATE: December 7, 1999

TO: Members

FROM: Legal Department  
Regulatory Service Division

RE: **Front-Running of Blocks**

This Regulatory Circular relates to the Exchange's Regulatory Circular RG 99-224, which was first published in July, 1987, and presents the Exchange's enforcement policy with respect to certain practices generally referred to as "front-running of blocks". This circular is not all inclusive and does not supplant existing policy as published in the CBOE Rule Book. Additionally, conduct not specifically described in this circular may nevertheless constitute front-running that comes within the broad prohibition of Exchange Rule 4.1, Just and Equitable Principles of Trade. For a complete record of the Exchange's policy regarding front-running please refer to Exchange Regulatory circular RG 99-224.

**FRONT-RUNNING OF BLOCKS BRIEFLY DEFINED**

Front-running is trading in a security while in possession of material non-public information concerning an imminent block transaction in the same security or a security that underlies such security. Front-running may be based on knowledge of less than all of the terms of the imminent block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will imminently be agreed upon.

In order for information concerning the block transaction to be considered publicly disseminated it must be disseminated via the tape or high speed communication line of the last sale reporting system administered by either CTA or OPRA. Public outcry on the Exchange Floor generally shall not be deemed to make such information publicly available.

The possession, disclosure or acquisition of block information, prior to its public dissemination, is not alone a violation of the front-running prohibition. Selective disclosure of stock information may, however, violate Exchange Rule 4.1. A front-running violation occurs when the possessor or acquirer trades in a security based upon the non-public information they now possess.

The Exchange's Regulatory Services Division will review all front-running complaints and refer all investigations involving front-running to the Exchange's Business Conduct Committee for appropriate disciplinary action. The Business Conduct Committee may impose serious disciplinary sanctions upon a finding of a violation of front-running, including but not limited to, suspensions from exchange membership and from association with exchange members and fines.

**The following are examples of front-running violations in which the Business Conduct Committee took disciplinary action and imposed sanctions. These examples are merely illustrative and are not meant to cover every type of conduct constituting front-running:**

**Example A**

A member organization and its nominee were jointly and severally fined five thousand dollars for the following conduct: On one trade date, the nominee bought several put option contracts from an Exchange Order Book Official. Approximately one minute later, a 100,000 share block transaction involving the underlying security was disseminated via the tape at a price down 1-5/8 points from the previous last sale. The nominee purchased the option contracts referred to above while he was in possession of material non-public information concerning the 100,000 share block transaction.

**Example B**

A member organization and its nominee were each censured and jointly and severally fined five thousand dollars for the following conduct: The member organization was solicited to participate in a buy-write transaction involving a customer order to sell certain call option contracts and to purchase equivalent shares of the common stock, which solicitation was relayed to the nominee. The nominee then initiated and executed other option transactions while in possession of the material non-public information concerning the imminent execution of the related stock-option orders and prior to the public dissemination of the subject share block of stock.

**Example C**

An Exchange member organization was fined fifteen thousand dollars and its former senior vice president and director ("officer") was fined five thousand dollars for the following conduct: The officer, on behalf of the member organization, caused to be entered and executed two orders to sell call option contracts while the officer knew of the material terms of an impending block transaction in the underlying security prior to the public dissemination of the block transaction.

**Example D**

A former Registered Representative of an Exchange member organization was censured and barred for six months from associating with any Exchange member or member organization for the following conduct: The Registered Representative, on behalf of his personal securities brokerage account at the member organization, initiated and caused to be executed an order to purchase put option contracts while he was in possession of material non-public information concerning imminent block transactions in the underlying security; and, on behalf of a relative's personal securities brokerage account at the member organization, initiated and caused to be executed an order in the underlying security on the NYSE while he was in possession of material non-public information concerning imminent block transactions in the underlying security.