



400 S. La Salle
Chicago, IL 60605

Regulatory Circular RG07-122

To: Members
From: Trading Operations
Date: November 19, 2007
Re: CFLEX Settings and Trading Procedures

On November 20, 2007, CBOE plans to launch trading on its FLEX Hybrid Trading System ("CFLEX"), which is a hybrid-style system that features electronic RFQs, open outcry RFQs and an electronic book. CFLEX will initially be implemented in the following options classes: CSCO, EBAY, GE, GOOG, HD, INTC, JNJ, MO, PFE, RUT and SPY.

Additional classes will begin moving from the existing FLEX trading (the "legacy platform") to the new CFLEX platform over the next several weeks. The implementation dates will be announced by separate circular.

The CFLEX settings will be as follows:

- **Trading Increments:** \$0.01 for all FLEX Options
- **Crossing Entitlements:**
 - RUT: 40% for electronic RFQ facilitations and solicitations; and the larger of 20%, a proportional share, \$1 million underlying equivalent value or the remaining underlying equivalent value on a closing transaction for open outcry RFQ facilitations only
 - SPY: 40% for electronic and open outcry RFQ facilitations only
 - All Other Equities: 40% for electronic and open outcry RFQ facilitations & solicitations
- **Electronic RFQ Timers:**
 - Response Period (T1): minimum of 10 seconds, maximum of 5 minutes
 - Reaction Period (T2): maximum of 5 minutes
 - Exposure Period (T3): minimum of 3 seconds
- **Open Outcry RFQ Timers:**
 - Response Period for FLEX Index Options and FLEX Equity Options on ETFs: minimum of 5 minutes
 - Response Period for all other FLEX Equity Options: minimum of 3 minutes

A detailed summary of the CFLEX trading procedures is attached. For further information, please go to www.cboe.com/CFLEX or refer to rule filing SR-CBOE-2006-99 located at www.cboe.org/Legal.¹ Additional questions may also be directed to Tom Foertsch at 312-735-6339 or to the CFLEX Helpdesk at 312-460-1941.

¹ Please note Transfer Packages that are offered at the FLEX post subject to the transfer procedures under Rule 6.49A will continue to be traded in open outcry only. For a detailed description of the transfer procedures, refer to Rule 6.49A.

CFLEX Trading Procedures

- **Market Participants:** There will be Qualified Market-Makers (“QMMs”) appointed to each class (see Rule 24B.9 for requirements); there will no longer be Appointed Market-Makers (“AMMs”) in the index classes. QMMs and brokers seeking to trade FLEX must file an amended letter of guarantee or authorization with CBOE’s Membership Department (6th Floor). You may obtain a form for such amended letter from the Membership Department. For those QMMs and brokers seeking to trade in open outcry on the Exchange’s trading floor, “E-FLEX” and/or “I- FLEX” will be printed on your badge. Only Market-Makers and brokers with these indicators on their badges may trade in open outcry. In addition, members’ customers seeking to have direct electronic access to the CFLEX system (referred to as “Sponsored Users”) must file a Sponsored User Agreement with the Membership Department (see Rule 6.20A). To confirm whether you have the current paperwork on file or to obtain the necessary forms, contact the Membership Department.
- **Product Terms & Specs:** These will be the same as had previously existed under the FLEX rules (see Rule 24B.4), including the applicable minimum value size requirements summarized below. Note that the minimum size requirements also apply to book trades.
 - For an opening transaction resulting from an RFQ or from trading against the book in a series in which there is no open interest, the lesser of 250 contracts or the number of contracts overlying \$1 million in the underlying securities in the case of FLEX Equity Options, and \$10 million Underlying Equivalent Value in the case of FLEX Index Options.
 - For a transaction in any currently-opened FLEX series resulting from an RFQ or from trading against the book, 100 contracts in the case of opening transactions in FLEX Equity Options and 25 contracts in the case of closing transactions in FLEX Equity Options, and \$1 million Underlying Equivalent Value in the case of both opening and closing transactions in FLEX Index Options, or in either case the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less.
 - For FLEX Quotes responsive to a FLEX Request for Quotes and FLEX Orders (undecrementated size) submitted to rest in the book, 25 contracts in the case of FLEX Equity Options, and \$1 million Underlying Equivalent Value in the case of FLEX Index Options, or in either case the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less.
- **Minimum Trading Increment:** The minimum trading increment will be \$0.01 for FLEX Index and FLEX Equity Options (previously FLEX Equity Options were subject to the standard \$0.05 and \$0.10 increments). These trading increments will apply to all FLEX Options, whether trading on the CFLEX platform or the legacy platform.
- **Position & Exercise Limits, Reporting Requirements:** For the applicable position and exercise limits, as well as reporting requirements, please refer to Rules 24B.7 and 24B.8.
- **Crossing Participation Entitlements:** The applicable crossing participation entitlements (after yielding to certain trading interests) will be as follows:
 - RUT: 40% for electronic RFQ facilitations and solicitations; and the larger of 20%, a proportional share, \$1 million underlying equivalent value or the remaining underlying equivalent value on a closing transaction for open outcry RFQ facilitations only
 - SPY: 40% for electronic and open outcry RFQ facilitations only

- All Other Equities: 40% for electronic and open outcry RFQ facilitations & solicitations

It should be noted that the initiator of an RFQ (referred to as the "Submitting Member" or "SM") utilizing the electronic or open outcry RFQ mechanics cannot cross an order with a QMM unless certain conditions are satisfied (see Rule 24B.5(d)(2)(i)(C)). It should also be noted that an agency order cannot be crossed with a principal or solicited order via the book unless the agency order is first subject to an RFQ and the agency order is exposed for at least 3 seconds or, in the case of a principal order being executed against an agency order, the SM has been bidding (offering) for at least 3 seconds prior to receiving the agency order (see Rule 24B.5(b)(3)).

- **Electronic RFQs:** To initiate a FLEX transaction using the electronic RFQ process, the SM submits an electronic RFQ containing the applicable contract terms. If the SM is seeking a crossing participation entitlement (discussed below), the SM must check the "intent to cross" box as part of the RFQ request. Various timers apply during an electronic RFQ:
 - **Response Period (T1):** minimum of 10 seconds, maximum of 5 minutes
T1 is a variable period set by the SM that denotes when responses can be entered, modified or canceled, including responses from the SM. Note that responses for the account of non-member Market-Makers (origin code "N") are not permitted and that responses for the account of a non-member broker-dealer must be submitted using the origin code "C."
 - **Reaction Period (T2):** maximum of 5 minutes
T2 is a period when the SM can decide to trade; responses can continue to be entered, modified or cancelled during T2, but no trading will occur until the SM determines to accept or reject the RFQ responses. Note that if the SM enters a response during T2, the SM must wait a minimum of 3 seconds before entering a contra-side order.
 - **Exposure Period (T3):** minimum of 3 seconds
T3 is a period that applies in crossing scenarios; if the SM enters an order during T2 that improves the BBO or matches the BBO but exceeds the available size, the SM must wait a minimum of 3 seconds before entering a contra-side order.
- **Open Outcry RFQs:** The procedures for open outcry RFQs for classes trading on the CFLEX platform differ in various respects from the traditional platform. The following summarizes the new CFLEX procedures:

RFQ Process:

- The submitting member must notify the FLEX Official (or other designee appointed by the Exchange in accordance with Rule 24B.14(a)) about all terms of the RFQ before notifying the trading crowd. Notification can be made over the phone but must be followed by a written RFQ form. The forms are available at the FLEX post. The RFQ must also include a response time interval specified in minutes and, except as provided below, must be for a period of at least 5 minutes for FLEX Index Options and FLEX Equity Options on ETFs, and a period of at least 3 minutes for all other FLEX Equity Options (these times will apply for options classes trading on the CFLEX platform and on the legacy platform). No RFQs can be submitted to the FLEX Official after 2:57 p.m. in a FLEX Equity Option class or 3:10 p.m. in a FLEX Index Option class (all times noted are Central).
- After submitting an RFQ to the FLEX Official, the SM must then immediately announce the terms and specifications of the RFQ to the trading crowd where the listed option is

traded. This communication must occur as soon as possible (and generally within 1 minute) following submission of the RFQ to the FLEX Official.

- FLEX quotes responsive to the RFQ may be provided to the SM and must be entered during the request response time by public outcry. QMMs who choose to participate must give quotes that satisfy the minimum value size requirements (described above). Agents representing customer and/or firm accounts may also participate provided they satisfy the minimum value size requirements. At the prescribed time, the SM will review all quotes for several seconds and will then announce the best bid and offer (“BBO”). Once the BBO is announced, the SM will have a reasonable amount of time to convey this information to the customer and determine if the customer will hit the bid or the offer, better the market or decline to trade.
- No trade shall take place sooner than the expiration of the request response time interval (e.g., 3 minutes after an RFQ for a FLEX Equity Option has been announced to the trading crowd). By this time, any public interest in response to the RFQ will be prepared to give a quote along with the QMMs in the trading crowd.
- If the SM does not intend to cross or act as principal with respect to any part of the FLEX trade, the SM shall promptly accept or reject the BBO; provided, however, that if the SM either rejects the BBO or is given a BBO for less than the entire size requested, all FLEX Traders present in the trading crowd (other than the SM) will have an opportunity during the BBO Improvement Interval in which to match or improve, as applicable, the BBO. At the expiration of any such BBO Improvement Interval, the SM must promptly accept or reject the BBO.
- If the SM indicates an intention to cross or act as principal with respect to any part of the FLEX trade, acceptance of the displayed BBO shall be automatically delayed until the expiration of the BBO Improvement Interval. Prior to the BBO Improvement Interval, the SM must announce to the trading crowd the price at which the SM expects to trade. In these circumstances, the SM may participate with all other FLEX Traders present in the trading crowd in attempting to improve or match the BBO during the BBO Improvement Interval. At the expiration of the BBO Improvement Interval, the Submitting Member must promptly accept or reject the BBO.
- If the SM accepts the best bid or offer, highest bid (lowest offer) shall have priority. Allocation among multiple best bids (offers) at the same price shall be as follows:
 - any crossing participation entitlement will have first priority; then
 - all other FLEX responses submitted in response to an open outcry RFQ will have second priority based on the sequence in which they are submitted; to the extent that two or more best bid (offer) responses are submitted in open outcry at the same time and same price, or the SM cannot reasonably determine the sequence in which the open outcry bid (offer) responses were made, priority will be apportioned equally among the open outcry bids (offers); then
 - trading interested represented in the book will have third priority.

All transactions must be in compliance with Section 11(a)(1) of the Securities Exchange Act of 1934 and the rules promulgated thereunder. Section 11(a)(1) prohibits a member from effecting transactions on the Exchange for the member’s own account, the account of an associated person, or an account over which the member or its associated person exercises investment discretion (collectively referred to as “proprietary” orders), unless an exception applies. Notwithstanding the priority provisions described above, bids (offers) submitted in open outcry on behalf of the proprietary account of a member relying on the

“G” exemption must yield priority to any bid (offer) at the same price that is represented in the book and all other bids (offers) represented in the trading crowd that have priority over the book.

- If the SM decides not to accept the best bid or offer made in response to the RFQ, any floor broker or QMM may accept the best bid or offer up to the size currently represented. If the SM accepts the best bid or offer, but there is excess size available, any floor broker or QMM may trade the balance available.

Trade Entry and Trade Reconciliation:

- If a trade takes place, the SM will report to the FLEX Official all pertinent information including price, quantity and buy/sell account information. All terms of each FLEX trade, including CMTA and Q-account, must be provided in a timely manner. Members risk the trade not clearing properly if this information is not provided.
- FLEX trade reports are available to member firm back-office personnel at the Trading Processing window at approximately 3:30 p.m. If any errors are discovered, the firm must contact the Trading Processing window no later than 4:00 p.m. After 4:00 p.m. no changes will be made to FLEX trades.
- The intention of these procedures is to eliminate the incidence of errors that can cause mis-cleared trades. Please be advised that any member or member firm that fails to observe each of these procedures will be responsible for any errors or mis-clears that may result.