Vodia Group Note

Vodia Group Publishes Impact of Reg SHO Options Market Maker Exemption on Options Liquidity

September 17, 2007

If the Reg SHO options market maker exemption is repealed, Vodia Group calculates a net reduction in all outstanding equity and index options contracts by 2.5% and a reduction of 87.7% in outstanding options contracts for hard to borrow underlying securities.

The SEC recently proposed to modify the Reg SHO options market maker exemption, which allows market makers to hedge options trades against short sales without borrowing the underlying equity. The main rationale for allowing the options market maker exemption has been to provide liquidity to the options markets. With a proposed repeal of the exemption, it is generally thought that liquidity in the options markets would be reduced.

Using both internal and external data, Vodia Group has conducted an analysis on the liquidity impact of repealing the options market maker exemption. Our analysis focuses on the economics for options market makers in the trade.

For a security to potentially affect options market liquidity, it must both have a negative rebate rate and have options traded against it; 156 securities met both conditions and were analyzed by Vodia Group. Nearly all of the relevant options are thinly traded and are close to at or the limit of allowed spreads, suggesting that any new costs associated with the trade would significantly reduce or eliminate market maker participation in the option altogether.

Please contact your Vodia Group representative if you are a client and would like more information about our methodology or additional data. For other inquiries, please contact us at info@vodiagroup.com.

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