

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57376; File No. SR-CBOE-2007-104)

February 25, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to List and Trade Range Options and Designating Range Options as Standardized Options Pursuant to Rule 9b-1 of the Exchange Act

I. Introduction

On September 6, 2007, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade range options. CBOE filed Amendment No. 1 to the proposal on December 3, 2007.³ The proposed rule change, as modified by Amendment No. 1,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced the original filing in its entirety. The purpose of Amendment No. 1 was to: (i) revise the proposed changes to CBOE Rule 12.3, Margin Requirements, to specify initial and/or maintenance margin requirements for margin and cash accounts and to conform the proposed rule text to existing rule text for other products; (ii) revise the proposed definitions of “Range Interval,” “Low Range and Low Range Exercise Value,” “High Range and High Range Exercise Value,” “Exercise Settlement Amount,” and to add a new proposed definition of “exercise price;” (iii) revise proposed CBOE Rule 20.3 to state specifically that Range Options are a separate class from other options overlying the same index; (iv) revise proposed CBOE Rules 20.6, Position Limits, and 20.7, Reports Related Position Limits and Liquidation of Positions, to provide that Range Options will be aggregated with other option contracts on the same underlying index, including other classes of Range Options overlying the same index, for position limit purposes; (v) revise proposed CBOE Rule 20.11 to reference certain rules of The Options Clearing Corporation (“OCC”); (vi) add new proposed CBOE Rule 20.12 to provide that, for purposes of Range Options, reference in the Exchange Rules to the “appropriate committee” shall be read to be the “Exchange;” (vii) provide additional information regarding FLEX options; (viii) delete footnote 2 from the original proposed rule change, because the proposal referenced therein, SR-CBOE-2006-99, is now effective (See Securities Exchange Act Release No. 56792 (November 15, 2007), 72 FR 65776 (November 23, 2007)); and (ix) make conforming changes, clarifications and corrections in the “Purpose” section of the filing.

was published for comment in the Federal Register on December 28, 2007.⁴ The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 1 and designates Range Options as standardized options pursuant to Rule 9b-1 of the Act.

II. Description of the Proposal

CBOE proposes to list and trade cash-settled, European-style Range Options that overlie any index eligible for options trading on the Exchange. Range Options will have a positive payout if the settlement value of the underlying index falls within the specified Range Length at expiration. Range Options will be based on the same framework as existing options that are traded on the Exchange. However, the maximum payout amount will be capped (as specified by the Exchange at listing) and the specific exercise settlement amount may vary based on where on the Range Length the settlement value of the underlying index value falls.

The Payout Structure of Range Options

The universe of possible payout amounts for Range Options resembles the shape of an isosceles trapezoid spread over a range of index values or the “Range Length.” The Range Length, or the bottom parallel (and longer) line of the trapezoid, defines the entire length of index values for which the option pays a positive amount if the settlement value of the underlying index falls within the specific Range Length. In other words, the Range Length equals the total span between two underlying index values, as set by the Exchange at listing, that is used to determine whether a Range Option is in or out of the money at expiration.

The Range Length is comprised of three segments that are defined by the “Range Interval,” which is a value that the Exchange will specify at listing and the minimum Range

⁴ See Securities Exchange Act Release No. 56993 (December 19, 2007), 72 FR 73913.

Interval will be at least 5 index points. Using the isosceles trapezoid diagram below, the “Range Interval,” defines congruent triangles on opposite sides of the trapezoid, which have base angles of equal degrees and equal base lengths.

The first triangle at the start of the Range Length defines the “Low Range” for the Range Option and if the settlement value of the underlying index value falls in the Low Range (the “Low Range Exercise Value”), the option will pay an amount that increases as the index value increases within the Low Range. To determine the exercise settlement amount if the settlement value of the index falls within the Low Range, the Low Range Exercise Value will be multiplied by the contract multiplier, set by the Exchange at listing.

The second triangle at the end of the Range Length defines the “High Range” for the Range Option and if the settlement value of the underlying index falls in the High Range, the option will pay an amount that decreases as the index value increases within the High Range (“High Range Exercise Value”). To determine the exercise settlement amount if the settlement value of index falls within the High Range, the High Range Exercise Value will be multiplied by the contract multiplier, set by the Exchange at listing. Lastly, the Low Range and High Range are segments of equal lengths at opposite ends on the Range Length and if the settlement value of the underlying index falls at the starting value of the Low Range, at the ending value of the High Range or outside of either the Low Range or the High Range, the option will pay \$0.



The third segment of the Range Option is defined as the “Middle Range,” and its length is equal to the Range Length minus twice the Range Interval, or as illustrated in the above diagram, its length is equal to the length of the top parallel (and shorter) line of the trapezoid. If the settlement value of the underlying index falls anywhere within the Middle Range at expiration, the payout is a fixed amount (set by the Exchange at listing) and does not vary depending on where in the Middle Range the index value falls. Also, if the index value falls in the Middle Range, this will be the highest amount that can be paid out for a Range Option and is defined as the “Maximum Range Exercise Value.” To determine the exercise settlement amount if the settlement value of the index falls anywhere within the Middle Range, the Maximum Range Exercise Value will be multiplied by the contract multiplier, set by the Exchange at listing.

Unlike other options, Range Options will only be of a single type, and there will not be traditional calls and puts. Also, the exercise or “strike” price for Range Options will be the Range Length that, akin to a regular strike price, will be used to determine if the Range Option is in or out of the money. When applicable, the “strike price” for a Range Option (i.e., the Range Length) will be used to determine the degree that the option is in-the-money (capped at the Maximum Range Exercise Value) if the settlement value of the underlying index falls within either the High or Low Range of the Range Length.

Benefits of Range Options

The Exchange believes that the introduction of Range Options will provide advantages to the investing public that are not provided for by other index options. First, the Exchange believes that Range Options offer investors a relatively low risk security where the risk reduction results from knowing the maximum risk exposure when the contract is written. While there may

be variations in the exercise settlement amount, the maximum exercise settlement amount is set at listing and the maximum risk therefore is limited and known at listing. Second, Range Options are structured similar to two-sided European-style binary options that provide additional flexibility because the option pays a reduced amount if the underlying index settles outside the main range covered by the option.

Proposed New Rules

To accommodate the introduction of Range Options, the Exchange proposes to adopt new Chapter XX to its rules and to make amendments to existing CBOE Rules 6.1, Days and Hours of Business, and 12.3, Margin Requirements. An introductory paragraph to Chapter XX will explain that the proposed rules in the proposed Chapter are applicable only to Range Options. Trading in Range Options also will be subject to the rules in Chapter I through XIX, XXIV, XXIVA and XXIVB, in some cases supplemented by the proposed rules in the Chapter, except for existing rules that will be replaced by the proposed rules in the Chapter and except where the context otherwise requires. As proposed, the majority of the rules governing index options will equally apply to Range Options. Those new proposed rules and those proposed amendments to existing rules pertaining to Range Options are described below.

(a) Definitions (CBOE Rule 20.1)

New Chapter XX, Range Option Contracts, includes new definitions applicable to Range Options in CBOE Rule 20.1. In particular, the terms “Range Option,” “settlement value,” “Range Length,” “Range Interval,” “Low Range and Low Range Exercise Value,” “High Range and High Range Exercise Value,” “Middle Range and Maximum Range Exercise Value,” “contract multiplier,” “exercise settlement amount,” and “exercise price” will be defined.

(b) Days and Hours of Business (CBOE Rule 20.2 and Amendment to CBOE Rule 6.1)

CBOE Rule 20.2 and an amendment to CBOE Rule 6.1, Days and Hours of Business Days and Hours of Business, provides that transactions in Range Options may be effected during normal Exchange option trading hours for other options on the same index.

(c) Designation of Range Option Contracts and Maintenance Listing Standards (CBOE Rules 20.3 and 20.4)

CBOE Rule 20.3 provides that the Exchange may from time to time approve for listing and trading on the Exchange Range Option contracts that overlie any index that is eligible for options trading on the Exchange. Range Options will be a separate class from other options overlying the same index. The Exchange may add new series of Range Options of the same class (i.e., overlying the same index) as provided for by the rules governing options on the same underlying index. Additional series of Range Options may be opened for trading on the Exchange when the Exchange deems it necessary to maintain an orderly market or to meet customer demand. The opening of a new series of Range Options on the Exchange will not affect any other series of options of the same class previously opened.

CBOE Rule 20.4 provides that the maintenance listing standards with respect to options on indexes set forth in CBOE Rule 24.2 and the Interpretations and Policies thereunder will be applicable to Range Options on indexes. CBOE Rule 24.2, Designation of the Index, sets forth initial and maintenance listing criteria for index options.

(d) Limitation of Liability of Exchange and of Reporting Authority (CBOE Rule 20.5)

CBOE Rule 20.5 provides that CBOE Rule 6.7, Exchange Liability, will be applicable in respect of any class of Range Options and that CBOE Rule 24.14, Disclaimers, will be applicable in respect of any reporting authority that is the source of values of any index underlying any class of Range Options.

(e) Position Limits, Reporting Relating to Position Limits and Liquidation of Positions and Exercise Limits (CBOE Rules 20.6 – 20.8)

CBOE Rule 20.6 provides that in determining compliance with CBOE Rules 4.11, Position Limits, 24.4, Position Limits for Broad-Based Index Options, 24.4A, Position Limits for Industry Index Options, and 24.4B, Position Limits for Options on Micro Narrow-Based Indexes as Defined Under Rule 24.2(d), cash-settled Range Options will have position limits equal to the position limits for options on the same underlying index. In determining compliance with the applicable position limits, Range Options must be aggregated with other option contracts on the same underlying index, including other classes of Range Options overlying the same index.

CBOE Rule 20.7 provides that Range Options will be subject to the same reporting and other requirements triggered for options on the same underlying index. In computing reportable Range Options, Range Options will be aggregated with other option contracts on the same underlying index, including other classes of Range Options overlying the same index.

CBOE Rule 20.8 provides that exercise limits for Range Options will be the same as those exercise limits for other options on the same underlying index. To illustrate, CBOE Rule 24.4 provides that the standard position limit for options on the CBOE Russell 2000 Volatility Index (“RVX”) is 50,000 contracts, and the near-term position limit is 30,000 contracts.

Therefore, the standard position limit for Range Options overlying the RVX also will be 50,000 contracts, and the near-term position limit would be 30,000 contracts. The 30,000 contract near-term position limit will also be the applicable exercise limit for Range Options on the RVX.⁵

For the purpose of determining compliance with the above limits, Range Options on the RVX will be aggregated with all other options on the RVX, including all series of Range Options on the RVX. This same aggregation will also be utilized to calculate the reporting requirements set forth in CBOE Rule 4.13, Reports Related to Position Limits.⁶

(f) Determination of Settlement Value of the Underlying Index (CBOE Rule 20.9)

CBOE Rule 20.9 provides that Range Options that are “in-the-money,” or “out-of-the-money” will be a function of the settlement value of the underlying index and whether at expiration the settlement values will fall within or outside of the Range Length.

(g) Premium Bids and Offers; Minimum Increments (CBOE Rule 20.10)

CBOE Rule 20.10 provides that all bids or offers made for Range Option contracts will be deemed to be for one contract unless a specific number of option contracts is expressed in the bid or offer. A bid or offer for more than one option contract, which is not made all-or-none, will be deemed to be for that amount or any lesser number of option contracts. An all-or-none bid or offer will be deemed to be made only for the amount stated. CBOE Rule 20.10 also will provide that all bids or offers made for Range Option contracts would be governed by the CBOE Rule 24.8, Meaning of Premium Bids and Offers, as that rule applies to index options.

⁵ See CBOE Rule 24.5, Exercise Limits, which provides, *inter alia*, that in determining compliance with CBOE Rule 4.12, exercise limits for index option contracts shall be applicable to the position limits prescribed for option contracts with the nearest expiration date in CBOE Rules 24.4 or 24.4A.

⁶ CBOE Rule 4.13 sets forth the general reporting requirement for customer accounts that maintain a position in excess of 200 contracts (long or short) in any single class of option contracts.

(h) Exercise of Range Options (CBOE Rule 20.11)

CBOE Rule 20.11 provides that Range Options will be exercised at expiration if the settlement value of the underlying index falls within the Range Length, and that Range Options will be subject to the exercise by exception processing procedures set forth in OCC Rules 805 and 1804. OCC Rules 805 and 1804 contain provisions that, inter alia, permit option holders to give instructions to not exercise an option contract.

(i) Exchange Authority (CBOE Rule 20.12)

CBOE Rule 20.12 provides that for purposes of Range Options, references in the Exchange's Rules to the appropriate committee shall be read to be the Exchange.⁷ The Exchange proposed this provision because it may determine to assign the applicable authorities with respect to Range Options to committees and/or Exchange staff. This provision will provide the Exchange with the flexibility to delegate the authorities under the rules with respect to Range Options to an appropriate committee or appropriate Exchange staff and will not have to make a rule change merely to accommodate the reassignment of such authority. For example, the Exchange may determine to delegate the authority to determine the applicable opening parameter settings to the Office of the Chairman.

⁷ Thus, for example, references to determinations regarding the applicable opening parameter settings established by the "appropriate Procedure Committee" in CBOE Rule 6.2B, Hybrid Opening System ("HOSS"), shall be read to be by the "Exchange." See e.g., Securities Exchange Act Release No. 55919 (June 18, 2007), 72 FR 34495 (June 22, 2007) (rule change providing, inter alia, that for purposes of Credit Options, references in the Exchange Rules to the appropriate committee shall be read to be the Exchange.).

(j) FLEX Trading (CBOE Rule 20.13)

CBOE Rule 20.13 provides that Range Options will be eligible for trading as Flexible Exchange Options, as provided for in Chapter XXIVA and XXIVB.⁸ For purposes of CBOE Rules 24A.4 and 24B.4, the parties will designate the Range Length, Range Interval and Maximum Exercise Value. CBOE Rules 24A.9 and 24B.9, regarding the minimum quote width, will not apply to Range Options.

(k) Margin (Amendment to CBOE Rule 12.3)

The Exchange proposes to amend CBOE Rule 12.3, Margin Requirements, to include requirements applicable to Range Options.⁹ Under the proposed requirements, for a margin account, no Range Option carried for a customer will be considered of any value for purposes of computing the margin requirement in the account of such customer and each Range Option carried for a customer will be margined separately. The initial and maintenance margin required on any Range Option carried long in a customer's account will be 100% of the purchase price of such Range Option. The initial and maintenance margin required on any Range Option carried short in a customer's account will be the Maximum Range Exercise Value times the contract multiplier.

For a cash account, a Range Option carried short in a customer's account will be deemed a covered position, and eligible for the cash account if either one of the following is held in the account at the time the option is written or is received into the account promptly thereafter:

⁸ FLEXible EXchange® Options (FLEX Options) are customized equity or index option contracts that provide investors with the ability to customize key contract terms, like exercise prices, exercise styles and expiration dates.

⁹ The Exchange proposes the addition of new subparagraph (n) to CBOE Rule 12.3 for Range Options and proposes to reserve subparagraph (m) of this rule. The Exchange will reserve subparagraph (m) because it previously proposed to use that paragraph to codify margin requirements for a product that is the subject of another rule filing. See SR-CBOE-2006-105 (proposal to list and trade binary options on broad based indexes).

(i) cash or cash equivalents equal to 100% of the Maximum Range Exercise Value times the contract multiplier; or (ii) an escrow agreement. The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement: (A) cash, (B) cash equivalents, (C) one or more qualified equity securities, or (D) a combination thereof having an aggregate market value of not less than 100% of the Maximum Range Exercise Value times the contract multiplier and that the bank will promptly pay the member organization the cash settlement amount in the event the account is assigned an exercise notice.

The Exchange believes that these proposed levels are appropriate because risk exposure will be limited with Range Options and the proposed customer initial and maintenance margin will be equal to the maximum risk exposure.¹⁰

(l) Options Disclosure Document

It is expected that OCC will seek a revision to the Options Disclosure Document (“ODD”) to incorporate Range Options.

(m) Systems Capacity

The Exchange represents that it believes the Exchange and the Options Price Reporting Authority have the necessary systems capacity to handle the additional traffic associated with the listing and trading of Range Options. The Exchange does not anticipate that there will be any additional quote mitigation strategy necessary to accommodate the trading of Range Options.

¹⁰ In accordance with CBOE Rule 12.10, Margin Required is Minimum, the Exchange has the ability to determine at any time to impose higher margin requirements than those described above in respect of any Range Option position when it deems such higher margin requirements are appropriate.

(n) Surveillance Program

The Exchange represents that it will have in place adequate surveillance procedures to monitor trading in Range Options prior to listing and trading such options, thereby helping to ensure the maintenance of a fair and orderly market for trading in Range Options.

III. Discussion

The Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹² which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that Range Options would provide investors with a potentially useful investment choice. The Commission notes that investors now can replicate the features and structure of Range Options through the use of currently available options traded on the Exchange.¹³

¹¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

¹³ The payout structure of a Range Option can be replicated by purchasing four calls or puts with varying strike prices. Range Options will enable investors to obtain the same payout structure by purchasing one option, with the potential of significantly reducing investors' transaction costs. Therefore, the Commission is designating Range Options as standardized options for purposes of the options disclosure framework established under Rule 9b-1 of the Act. See Securities Exchange Act Release Nos. 31910 (February 23, 1993), 58 FR 12056 (March 2, 1993) and 34925 (November 1, 1994), 59 FR 55720 (November 8, 1994).

The Commission notes that it previously approved rules relating to the listing and trading of FLEX Options on CBOE, which give investors and other market participants the ability to individually tailor, within specified limits, certain terms of those options.¹⁴ The current proposal incorporates Range Options that trade as FLEX Options into these existing rules and regulatory framework. The Commission finds that the Exchange's proposal to allow Range Options to be eligible for trading as FLEX Options is consistent with the Act.

The Commission believes that the proposed position limits and margin rules for Range Options are reasonable and consistent with the Act. Setting position and exercise limits on Range Options that are equal to those limits on options on the same underlying index appears to reasonably balance the promotion of a free and open market for these securities with minimization of incentives for market manipulation. In addition, the proposed margin rules appear reasonably designed to deter a member or its customer from assuming an imprudent position in Range Options.

In support of its proposal, CBOE made the following representations:

- CBOE has in place an adequate surveillance program to monitor trading in Range Options and intends to largely apply its existing surveillance program for options to the trading of Range Options; and
- CBOE has the necessary systems capacity to support the new options series that would result from the introduction of Range Options.

This approval order is based on CBOE's representations.

¹⁴ See Securities Exchange Act Release No. 31910 (February 23, 1993), 58 FR 12056 (March 2, 1993).

III. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-CBOE-2007-104), as modified by Amendment No. 1, is hereby approved.

IT IS FURTHER ORDERED, pursuant to Rule 9b-1(a)(4) under the Act,¹⁵ that Range Options are designated as standardized options.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

Florence E. Harmon
Deputy Secretary

¹⁵ 17 CFR 240.9b-1(a)(4).

¹⁶ 17 CFR 200.30-3(a)(12).