SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58207; File No. SR-CBOE-2008-26)

July 22, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change to List and Trade Options on the BXM Index (1/10th Value)

I. Introduction

On June 2, 2008, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to 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 options on the BXM Index (1/10th value). The proposed rule change was published for comment in the Federal Register on June 18, 2008.[3] The Commission received no comments regarding the proposal. This order approves the proposed rule change.

II. Description of the Proposal

CBOE proposes to list and trade cash-settled, European-style options on an index that is equal to 1/10th of the value of the CBOE S&P 500 BuyWrite Index ("BXM" or "BXM Index").[4]

Index Design

The BXM Index measures the total rate of return of a hypothetical "covered call" strategy applied to the S&P 500 Composite Price Index (the "S&P 500 Index"). This strategy, referred to

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 57946 (June 10, 2008), 73 FR 34811 ("Notice").

4 The Exchange is not currently proposing to list and trade options that overlie the full-value BXM Index.

CBOE Futures Exchange, LLC ("CFE") currently lists and trades CBOE S&P 500 BuyWrite Index future contracts, which commenced trading on October 2, 2006.

as the “BXM covered call strategy,” consists of a hypothetical portfolio consisting of a “long” position indexed to the S&P 500 Index on which are deemed sold a succession of one-month, at-the-money call options on the S&P 500 Index listed on the Exchange. This hypothetical portfolio is referred to as the “covered S&P 500 Index portfolio.”

The BXM Index provides a benchmark measure of the total return performance of this hypothetical portfolio. Dividends paid on the component stocks underlying the S&P 500 Index and the dollar value of option premium deemed received from the sold call options are functionally “re-invested” in the covered S&P 500 Index portfolio. The BXM Index is based on the cumulative gross rate of return of the covered S&P 500 Index portfolio since the inception of the BXM Index on June 1, 1988, when it was set to an initial value of 100.00.

The BXM covered call strategy requires that each S&P 500 Index call option in the hypothetical portfolio be held to maturity, generally the third Friday of each month. The call option is settled against the Special Opening Quotation (“SOQ”) of the S&P 500 Index used as the final settlement price of S&P 500 Index call options.[5] The SOQ is a special calculation of the S&P 500 Index that is compiled from the opening prices of component stocks underlying the S&P 500 Index that is performed when all 500 stocks underlying the S&P 500 Index have opened for trading, and is usually determined before 10:00 a.m. Chicago time.[6] The final settlement price of the call option at maturity is the greater of 0 and the difference between the SOQ minus the strike price of the expiring call option.

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5 If the third Friday of the month is an exchange holiday, the call option will be settled against the SOQ on the previous business day and the new call option will be selected on that day as well.

6 If one or more stocks in the S&P 500 Index do not open on the day the SOQ is calculated, the final settlement price for SPX options is determined in accordance with the Rules and By-Laws of The Options Clearing Corporation (“OCC”).

Subsequent to the settlement of the expiring call option, a new at-the-money call option expiring in the next month is then deemed written, or sold, a transaction commonly referred to as a "roll." The strike price of the new call option is the S&P 500 Index call option listed on CBOE with the closest strike price above the last value of the S&P 500 Index reported before 10:00 a.m. Chicago time.[7] Once the strike price of the new call option has been identified, the new call option is deemed sold at a price equal to the volume-weighted average of the traded prices ("VWAP") of the new call option during the half-hour period beginning at 10:30 a.m. Chicago time. CBOE calculates the VWAP in a two-step process: first, CBOE excludes trades in the new call option between 10:30 a.m. and 11:00 a.m. Chicago time that are identified as having been executed as part of a "spread," and then CBOE calculates the weighted average of all remaining transaction prices of the new call option between 10:30 a.m. and 11:00 a.m. Chicago time, with weights equal to the fraction of total non-spread volume transacted at each price during this period. The source of the transaction prices used in the calculation of the VWAP is CBOE's Market Data Retrieval ("MDR") System.[8] If no transactions occur in the new call option between 10:30 a.m. and 11:00 a.m. Chicago time, then the new call option is deemed sold at the last bid price reported before 11:00 a.m. Chicago time. The value of option premium deemed received from the new call option is functionally "reinvested" in the portfolio.

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[7] If the last value of the S&P 500 Index reported before 10:00 a.m. Chicago time is exactly equal to a listed S&P 500 Index call option strike price, then the new call option is the S&P 500 Index call option with that exact at-the-money strike price.

[8] Time and sales information from CBOE's MDR System is disseminated through the Options Price Reporting Authority ("OPRA") and is publicly available through most price quote vendors.

Index Calculation

The BXM Index is calculated in real-time by CBOE every 15 seconds during each trading day, excluding roll dates (for the respective components of the covered S&P 500 Index portfolio). The BXM Index calculation is disseminated through OPRA and is publicly available through most price quote vendors.[9] The BXM Index is a chained index, i.e., its value is equal to 100 times the cumulative product of gross daily rates of return of the covered S&P 500 Index portfolio since the inception date of the BXM Index.[10]

Options Trading

BXM options will be quoted in terms of the underlying BXM Index (1/10th value). Both options prices and cash index levels will be stated in decimal format and one point will equal $100. The minimum tick size for series trading below 3.00 will be 0.05 point ($5.00), and the minimum tick for series trading at and above 3.00 will be 0.10 point ($10.00). In accordance with Rule 24.9(a)(2), the Exchange will typically list three near-term expiration months and three additional expiration months from the March quarterly cycle (March, June, September and December).

The minimum strike price interval for BXM options will be 0.01 point ($1.00). The Exchange will initially list at least two strike prices above and two strike prices below the current value of the BXM Index (1/10th value) at or about the time a series is opened for trading on the Exchange. As part of this initial listing, the Exchange will list strike prices that are within 5 points from the closing value of the BXM Index (1/10th value) on the preceding day.

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9 Information regarding the BXM Index may be found on CBOE's Web site at the following Internet address: www.cboe.com/micro/bxm.

10 See Notice, supra note 3 for further discussion of the BXM Index calculation.

The Exchange proposes to add additional series when the Exchange deems it necessary to maintain an orderly market, to meet customer demand, or when the underlying BXM Index (1/10th value) moves substantially from the initial exercise price or prices. To the extent that any additional strike prices are listed by the Exchange, such additional strike prices shall be within 30 percent above or below the closing value of the BXM Index (1/10th value). The Exchange will also be permitted to open additional strike prices that are more than 30 percent above or below the current BXM Index (1/10th value) provided that customer interest for such series is demonstrated and expressed by institutional, corporate or individual customers or their brokers. Market-Makers trading for their own account would not be considered when determining customer interest. In addition to the initial listed series, the Exchange may list up to 60 additional series per expiration month for each series in BXM options. In addition, the Exchange proposes that it shall not list LEAPS on BXM options at intervals less than $5.

The Exchange also proposes to set forth a delisting policy with respect to BXM options. Specifically, the Exchange will, on a monthly basis, review series that are outside a range of five strikes above and five strikes below the current value of the BXM Index (1/10th value) and delist series with no open interest in both the put and the call series having a: (i) strike higher than the highest strike price with open interest in the put and/or call series for a given expiration month; and (ii) strike lower than the lowest strike price with open interest in the put and/or call series for a given expiration month. Notwithstanding the proposed delisting policy, customer requests to add strikes and/or maintain strikes in BXM options in series eligible for delisting will be granted.[11]

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[11] The Exchange also proposes to add new Interpretation and Policy .11 to Rule 5.5, Series of Option Contracts Open for Trading, which would be an internal cross reference stating

Exercise and Settlement

The proposed options will expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 3:15 p.m. Chicago time on the business day preceding the last day of trading (ordinarily the Thursday before expiration Saturday, unless there is an intervening holiday). When the last trading day is moved because of an Exchange holiday (such as when CBOE is closed on the Friday before expiration), the last trading day for expiring options will be Wednesday and the SOQ of the BXM Index will be calculated on Thursday.

Exercise will result in delivery of cash on the business day following expiration. BXM options will be A.M.-settled. As described above, the exercise settlement value of a BXM option shall be a SOQ of the BXM Index (1/10th value). The exercise-settlement amount is equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by $100.

If the exercise settlement value is not available or the normal settlement procedure cannot be utilized due to a trading disruption or other unusual circumstance, the settlement value will be determined in accordance with the rules and bylaws of the OCC.

Surveillance

The Exchange states that it will use the same surveillance procedures currently utilized for each of the Exchange's other index options to monitor trading in BXM options. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in options on these option products. For surveillance purposes, the Exchange will have

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that the intervals between strike prices for BXM option series would be determined in accordance with proposed new Interpretation and Policy .01(f) to Rule 24.9.

complete access to information regarding trading activity in the pertinent underlying securities (i.e., S&P 500 Index component securities).

Position and Exercise Limits; Reporting of Positions

The Exchange is not proposing to establish any position and exercise limits for BXM options. Because the BXM Index (1/10th value) is calculated using values of the S&P 500 Index, the Exchange believes that the position and exercise limits for this new product should be the same as those for broad-based index options (e.g. SPX) for which there are no position limits.

BXM options will be subject to the same reporting and other requirements triggered for other options dealt in on the Exchange.[12]

Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX, XXIV, XXIVA, and XXIVB will equally apply to BXM options. BXM options will be margined as "broad-based index" options, and under CBOE rules, especially, Rule 12.3(c)(5)(A), the margin requirement for a short put or call shall be 100% of the current market value of the contract plus up to 15% of the respective underlying indicator value. Additional margin may be required pursuant to Exchange Rule 12.10.

The Exchange proposes to designate BXM options as eligible for trading as Flexible Exchange Options as provided for in Chapters XXIVA (Flexible Exchange Options) and XXIVB (FLEX Hybrid Trading System).

Capacity

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12 See e.g., Rule 4.13, Reports Related to Position Limits. For purposes of calculating reportable positions, the Exchange has employed a contract factor of 10 for determining reporting and other requirements for BXM options. For example, the reporting requirements of Rule 24.4.03 for BXM options will be triggered when an end of day aggregate position exceeds 1 million contracts.

CBOE represents that it believes the Exchange and the OPRA have the necessary systems capacity to handle the additional traffic associated with the listing of new series that would result from the introduction of BXM options.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[13] Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,[14] which requires, among other things, that the rules of a national securities exchange be designed 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 the BXM Index (1/10th value) options should provide investors with a potentially useful investment choice. The Commission believes that permitting $1.00 strike price intervals for BXM option series will provide investors with added flexibility in the trading of BXM options and further the public interest by allowing investors to establish positions that are better tailored to meet their investment objectives. Further, the Commission notes that it has previously approved Exchange rules that permit the Exchange to list series at $1.00 or lower strike price intervals in similar option products.[15] The Commission also believes

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13 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).

14 15 U.S.C. 78f(b)(5).

15 Rule 24.9.01(b) permits the CBOE to list series on options based on one-one hundredth (1/100th) of the value of the Dow Jones Industrial Average Index at no less than $0.50 intervals. See Securities Exchange Act Release No. 39011 (September 3, 1997), 62 FR 47840 (September 11, 1997) (SR-CBOE-1997-26). Rule 24.9.11 allows the Exchange to list strike price intervals at no less than $1 for the Mini-SPX option, which is based on 1/10th the value of the S&P 500 Index. See Securities Exchange Act Release Nos. 52625

that the proposal strikes a reasonable balance between the Exchange's desire to accommodate market participants by offering a wider array of investment opportunities and the need to avoid unnecessary proliferation of options series and the corresponding increase in quotes. The Commission notes that the delisting policy proposed by the Exchange is designed to mitigate the number of options series with no open interest, which would reduce quote traffic accordingly.

The Commission notes that the BXM Index is calculated in real time by CBOE every 15 seconds during each trading day. The BXM Index calculation is disseminated through OPRA, and is publicly available through most price quote vendors.

Because the BXM Index is calculated using values of the S&P 500 Index, the Commission believes it is appropriate that the position and exercise limits for BXM options be the same as for other broad-based index options, which similarly have no position and exercise limits. Further, the Commission notes that the margin requirements for broad-based index options will also apply to BXM options.

The Commission also believes that the Exchange's proposal to allow BXM options to be eligible for trading as FLEX options is consistent with the Act. The Commission previously approved rules relating to the listing and trading of FLEX Options on CBOE, which gives investors and other market participants the ability to individually tailor, within specified limits, certain terms of those options.[16] The current proposal incorporates BXM (1/10th value) options that trade as FLEX Options into these existing rules and regulatory framework.

(October 18, 2005), 70 FR 61479 (October 24, 2005) (SR-CBOE-2005-81) and 57049 (December 27, 2007), 73 FR 528 (January 3, 2008) (SR-CBOE-2007-125).

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

The Commission notes that CBOE represented that it had an adequate surveillance program to monitor trading of options on the BXM Index ($1/10^{th}$ Value) and intends to apply its existing surveillance program to support the trading of these options. In approving the proposed rule change, the Commission has also relied upon the Exchange's representation that it has the necessary systems capacity to support new options series that will result from this proposal. The Commission expects the Exchange to continue to monitor for option series with little or no open interest and trading activity and, consistent with the delisting policy approved today as part of this proposed rule change, to act promptly to delist such options.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[17] that the proposed rule change (SR-CBOE-2008-26) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[18]

Florence E. Harmon
Acting Secretary

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[17] 15 U.S.C. 78s(b)(2).

[18] 17 CFR 200.30-3(a)(12).