

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-56821; File No. SR-CBOE-2007-82)

November 20, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of Proposed Rule Change as Modified by Amendment No. 1 Thereto to Allow the Exchange to List Up to Seven Expiration Months for Broad-Based Security Index Options Upon Which the Exchange Calculates a Constant Three-Month Volatility Index

I. Introduction

On July 17, 2007, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to permit the Exchange to: (i) amend Rule 24.9(a)(2), Terms of Index Option Contracts, to allow the Exchange to list up to seven expiration months for broad-based security index options upon which the Exchange calculates a constant three-month volatility index; and (ii) remove outdated rule text from Rule 24.9(a)(2). On September 19, 2007, CBOE filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on October 16, 2007.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposal

In its proposal, CBOE proposed to amend Rule 24.9(a)(2), Terms of Index Options, to allow the Exchange to list up to seven expiration months for broad-based security index options upon which the Exchange calculates a constant three-month volatility index. Currently, Rule

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 56632 (October 9, 2007), 72 FR 58694 (“Notice”).

24.9(a)(2) permits the Exchange to list only six expiration months in any index options at any one time.

In the filing, CBOE explained that it had plans to introduce new volatility products and new volatility indexes in the near future, including the CBOE S&P 500 Three-Month Volatility Index ("VXV").<sup>4</sup> According to CBOE, VXV is a measure of S&P 500 implied volatility – the volatility implied by S&P option prices – but instead of reflecting a constant 1-month implied volatility period (like other volatility indexes such as the CBOE Volatility Index or "VIX"), VXV is designed to reflect the implied volatility of an option with a constant 3 months to expiration. Since there is only one day on which an option has exactly 3 months to expiration, VXV is calculated as a weighted average of options expiring immediately before and immediately after the three-month standard. Accordingly, the Exchange would need to use four consecutive expiration months in order to calculate a constant three-month volatility index.

CBOE stated in its filing that under the current application of CBOE Rule 24.9(a)(2), the Exchange generally lists three consecutive near term months and three months on a quarterly expiration cycle. One of the three consecutive near term months is always a quarterly month; however, that near term contract month (which is also a quarterly month) is not included as part of the three months listed on a quarterly expiration cycle. Therefore, in order to permit the addition of four consecutive near term months under current Rule 24.9(a)(2), the Exchange would only be able to list two months on a quarterly expiration cycle. Because of customer demand and other investment strategy reasons for having three months on a quarterly expiration cycle, the Exchange proposed to increase, from six to seven, the number of expiration months for

---

<sup>4</sup> The Exchange calculates volatility indexes on other broad-based security indexes, such as the Dow Jones Industrial Average index ("DJX"), the Nasdaq-100 index ("NDX"), and the Russell 2000 index ("RUT"). The Exchange may calculate a constant three-month volatility index on DJX, NDX or RUT in the future.

broad-based security index options upon which the Exchange calculates a constant three-month volatility index.

CBOE explained that without this proposed rule change, if the Exchange calculated a three-month volatility using only three consecutive near term months, this would result in the VXV being calculated with options expiring three months apart about one-third of the time.<sup>5</sup> Another one-third of the time, VXV would be calculated with options expiring two months apart. And the final one-third of the time, VXV would be calculated with options expiring one month apart. As a result, the calculation of the three-month VXV under current Rule 24.9(a)(2) would render the VXV subject to inconsistencies that, according to CBOE, may make the index unattractive as an underlying for volatility products.

Under the proposed rule change, however, the Exchange will be permitted, eight times a year, to add an additional seventh month in order to maintain four consecutive near term contract months.

The Exchange also proposed to remove outdated rule text from Rule 24.9(a)(2). Specifically, the Exchange proposed to delete the provision that permitted the Exchange to list up to seven expiration months at anyone time for the SPX, MNX and DJX index option contracts, provided that one of those expiration months is November 2004.<sup>6</sup>

---

<sup>5</sup> See Notice, *supra* note 3, at 58695 (providing examples to illustrate the effect of the proposed rule change).

<sup>6</sup> This provision was added in July 2004 in response to customer demand for index options expiring in November 2004 to hedge positions in stocks overlying particular index options or to hedge market exposure to the equity markets generally against the uncertainty presented by the elections. See Securities Exchange Act Release No. 50063 (July 22, 2004), 69 FR 45357 (July 29, 2004)(SR-CBOE-2004-49).

### Capacity

CBOE represented that it has analyzed its capacity and 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 additional listing of a seventh contract month in order to maintain four consecutive near term contract months for those broad-based security index options upon which the Exchange calculates a constant three-month volatility index.

### III. Discussion

After careful review, the Commission finds that CBOE's proposal to amend Rule 24.9(a)(2), Terms of Index Option Contracts, to allow the Exchange to list up to seven expiration months for broad-based security index options upon which the Exchange calculates a constant three-month volatility index, and to remove certain outdated rule text from Rule 24.9(a)(2) is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>7</sup> and, in particular, the requirements of Section 6 of the Act<sup>8</sup> and the rules and regulations thereunder. The Commission believes that increasing, from six to seven, the number of expiration months for broad-based security indexes on which the Exchange calculates a constant three-month volatility index (to accommodate a fourth consecutive near-term month while maintaining the listing of three months on a quarterly expiration cycle) will result in a more consistent and predictable calculation in which the option series that bracket three months to expiration will always expire one month apart, thereby promoting just and equitable principles of trade while protecting investors and the public interest.

---

<sup>7</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f.

The Commission also notes CBOE's representations that it possesses the necessary systems capacity to handle the additional traffic associated with the additional listing of a seventh contract month in order to maintain four consecutive near term contract months for those broad-based security index options upon which the Exchange calculates a constant three-month volatility index.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-CBOE-2007-82), as amended, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Florence E. Harmon  
Deputy Secretary

---

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).