

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57410; File No. SR-CBOE-2007-96)

March 3, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Amend the Quarterly Option Series Pilot Program to Permit the Listing of Additional Series

I. Introduction

On August 7, 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 proposal to amend its rules relating to the quarterly option series (“QOS”) pilot program (“Pilot Program”) to permit the listing of additional series and to adopt a delisting program for outlying QOS series with no open interest. On January 17, 2008, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on January 28, 2008.³ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposal

Current Exchange rules permit, on a pilot basis, the listing and trading of QOS in options on indexes or options on exchange-traded funds (“ETFs”) that satisfy the applicable listing criteria under CBOE rules.⁴ QOS trade based on calendar quarters that end in March, June,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 57170 (January 18, 2008), 73 FR 4927 (“Notice”).

⁴ See Securities Exchange Act Release No. 54123 (July 11, 2006), 71 FR 40558 (July 17, 2006) (SR-CBOE-2006-65) (“Pilot Program Release”). Under the pilot program, the Exchange may list QOS in up to five currently listed option classes that are either options

September and December. The Exchange lists QOS that expire at the end of the next consecutive four calendar quarters, as well as the fourth quarter of the next calendar year.

Currently, the Exchange lists QOS in five ETF options: (1) Nasdaq-100 Index Tracking Stock (QQQQ); (2) iShares Russell 2000 Index Fund (IWM); (3) DIAMONDS Trust, Series 1 (DIA); (4) Standard and Poor's Depository Receipts/SPDRs (SPY); and (5) Energy Select SPDR (XLE).

CBOE Rule 5.5(e)(3) provides that the Exchange shall list strike prices for a QOS that are within \$5 from the closing price of the underlying security on the preceding day. Recently, the Exchange has received requests from market participants to add additional strike prices for QOS that would be outside of the \$5 price range for setting strikes (hereinafter “+/- \$5 range”).

Investors and other market participants have advised the Exchange that they are buying and selling QOS options to trade volatility. In order to adequately replicate the desired volatility exposure, these market participants need to trade several option series, many having strike prices that fall outside the +/- \$5 range currently allowed under the QOS rules.

In addition, other participants have advised the Exchange that their investment strategies involve trading options tied to a particular option “delta,”⁵ rather than a particular level of the underlying security or index. At issue is the fact that delta depends on both the relative difference between the level of the underlying security or index and the option strike price, and time to expiration. For example, with IWM trading at \$85 per share, the strike price corresponding to a “25-delta” IWM call (i.e., a call option with a delta of 25) with one month to expiration would be 89. However, the strike price corresponding to a “25-delta” IWM call with

on ETFs or indexes. The Exchange is also permitted to list QOS in any options class that is selected by other securities exchanges that employ a similar pilot program under their respective rules.

⁵ “Delta” is a measure of how an option price will change in response to a \$1 price change in the underlying security or index. For example, an ABC option with a delta of “50” can be expected to change by \$0.50 in response to a \$1 change in the price of ABC.

3 months to expiration would be 93, and the strike price of a “25-delta” call with 1 year to expiration would be 106.

In short, CBOE has been advised that the +/- \$5 range for QOS in IWM options is insufficient to satisfy customer demand. In response, the Exchange proposes to amend Rule 5.5(e) to permit the Exchange to list strike prices for QOS in ETF options that fall within a percentage range (30%) above and below the price of the underlying ETF. Additionally, upon demonstrated customer interest, the Exchange also will be permitted to open additional strike prices of QOS in ETF options that are more than 30% above or below the current price of the underlying ETF. Market-Makers trading for their own account will not be considered when determining customer interest under this provision. In addition to the initial listed series, the proposal will permit the Exchange to list up to sixty (60) additional series per expiration month for each QOS in ETF options.

The Exchange also is proposing to implement a delisting policy. Under the proposed delisting policy, the Exchange will, on a monthly basis, review QOS series that are outside a range of five (5) strikes above and five (5) strikes below the current price of the underlying ETF, and delist series with no open interest in both the put and the call series having a strike price: (i) higher than the highest strike price with open interest in the put and/or call series for a given expiration month; or (ii) lower than the lowest strike price with open interest in the put and/or call series for a given expiration month.⁶ Notwithstanding the proposed delisting policy, the Exchange will grant customer requests to add strikes and/or maintain strikes in QOS eligible for delisting.

⁶ For a detailed example of how the delisting policy will work, see Notice, supra note 3, at 4928.

III. Commission's Findings and Order Granting Approval of the Proposed Rule Change

After careful review and based on the Exchange's representations, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁷ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act⁸ in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, 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.

Specifically, the Commission believes that the proposed expansion in the range and number of strike prices that the Exchange may list for QOS will provide investors with added flexibility in the trading of equity options and further the public interest by allowing investors to establish equity options positions that are better tailored to meet their investment objectives. The Commission also believes 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.

In approving the proposed rule change, the Commission has 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

⁷ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(5).

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. In addition, the Commission expects that CBOE will continue to monitor the trading volume associated with the additional option series listed as a result of this proposal and the effect of these additional series on market fragmentation and on the capacity of the Exchange's, OPRA's, and vendors' automated systems.

Finally, the Commission notes that this rule change will become part of the pilot program and, going forward, its effects will be considered by the Commission in the event that the Exchange seeks to renew or make permanent the pilot program.⁹ Thus, in the Exchange's future reports on the Pilot Program, the Exchange should include analysis of (1) the impact of the additional series on the Exchange's market and quote capacity, and (2) the implementation and effects of the delisting policy, including the number of series eligible for delisting during the period covered by the report, the number of series actually delisted during that period (pursuant to the delisting policy or otherwise), and documentation of any customer requests to maintain QOS strikes that were otherwise eligible for delisting.

⁹ As set forth in the Pilot Program Release, if the Exchange were to propose an extension, expansion, or permanent approval of the Pilot Program, the Exchange must submit, along with any filing proposing such amendments to the program, a report that provides an analysis of the Pilot Program covering the entire period during which the Pilot Program was in effect. See Pilot Program Release, *supra* note 4. The Pilot Program Release requires the Exchange to include in its report, at a minimum: (1) data and written analysis on the open interest and trading volume in the classes for which QOS were opened; (2) an assessment of the appropriateness of the option classes selected for the Pilot Program; (3) an assessment of the impact of the Pilot Program on the capacity of the Exchange, OPRA, and market data vendors (to the extent data from market data vendors is available); (4) any capacity problems or other problems that arose during the operation of the Pilot Program and how the Exchange addressed such problems; (5) any complaints that the Exchange received during the operation of the Pilot Program and how the Exchange addressed them; and (6) any additional information that would assist in assessing the operation of the Pilot Program.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-CBOE-2007-96), as modified by Amendment No. 1 thereto, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹¹

Florence E. Harmon
Deputy Secretary

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).