

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57012; File No. SR-CBOE-2007-03)

December 20, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Amending its Obvious Error Rule for Options on Indices, ETFs, and HOLDRS

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 21, 2007, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. On December 20, 2007, the CBOE submitted Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend CBOE Rule 24 .16, which is the Exchange’s rule applicable to the nullification and adjustment of transactions in index options, options on exchange-traded funds (“ETFs”), and options on HOLDing Company Depository Receipts (“HOLDRS”). The Exchange is proposing to amend the rule in order to: (i) modify the nullification and adjustment provisions for erroneous prints and erroneous quotes in the underlying; (ii) eliminate the nullification and adjustment provision for trades below intrinsic value; and (iii) modify the nullification provision for no bid series. The text of the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

change is available at the Exchange, the Commission's Public Reference Room, and www.cboe.com.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to make various amendments to CBOE Rule 24.16, which is its obvious error rule pertaining to index options, options on ETFs, and options on HOLDRS. First, the proposal would modify the rule's provisions pertaining to erroneous prints and erroneous quotes in the underlying. Currently, the rule provides that a trade resulting from an erroneous print disseminated in the underlying market which is later cancelled or corrected by that underlying market may be adjusted or nullified.³ Similarly, the rule also provides that a trade resulting from an erroneous quote in the underlying security may be adjusted or nullified.⁴

³ Under the current rule, to be adjusted or nullified, the trade must be the result of an erroneous print that is higher or lower than the average trade in the underlying security during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for such underlying security during the same period. See CBOE Rule 24.16(a)(3).

⁴ Under the current rule, an erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote

Under the revised rule, the appropriate Exchange committee would identify particular underlying or related instrument(s) that would be used to determine an erroneous print or quote and would also identify the relevant market(s) trading the underlying or related instrument to which the Exchange would look for purposes of applying the obvious error analysis. The underlying or related instrument(s) may include the underlying or related ETF(s), HOLDRS(s), and/or index value(s),⁵ and/or related futures product(s),⁶ and the relevant underlying market(s) may include one or more markets. The underlying or related instrument(s) and relevant market(s) would be designated by the appropriate Exchange committee and announced to the membership via Regulatory Circular. For a particular ETF, HOLDRS, index value, and/or futures product to qualify for consideration as a “related instrument,” the revised rule requires that: (i) the option class and related instrument must be derived from or designed to track the same underlying index; or (ii) in the case of S&P 100-related options, the options class and related instrument must be derived from or designed to track the S&P 100 Index or the S&P 500 Index. Thus, as an example for illustrative purposes only, for options on the Nasdaq 100 Index Tracking Stock (ETF option symbol “QQQ”) , the appropriate Exchange committee may determine to

width for such underlying security on the primary market during the time period encompassing two minutes before and after the dissemination of such quote. See Rule 24.16(a)(4).

⁵ An “index value” is the value of an index as calculated and reported by the index’s reporting authority. Use of an index value would only be applicable for purposes of identifying an erroneous print in the underlying (and not an erroneous quote). See proposed changes to CBOE Rule 24.16(a)(3).

⁶ To confirm, the Exchange states that it is only proposing that it may designate underlying or related ETF(s), HOLDRS(s), and/or index value(s), and/or related futures product(s). The Exchange states that it is not proposing to designate any of the individual underlying stocks (or related options or futures on any of the individual underlying stocks) that comprise a particular ETF, HOLDR, or index (any such proposal would be the subject of a separate rule filing).

designate the underlying Nasdaq 100 ETF and the primary market where it trades, as well as a related futures product overlying the Nasdaq 100 Index and the primary market where that futures product trades, as the instruments that would be considered by the Exchange in determining whether an erroneous print or an erroneous quote has occurred that would form the basis for an adjustment or nullification to a transaction in the related options.⁷

As another example for illustrative purposes only, for the Exchange's class of options on the S&P 100 Index (index option symbol "OEX"), the appropriate Exchange committee may determine to designate the following underlying or related instruments: the S&P 100 Index value as calculated and reported by Standard and Poor's (the index's reporting authority); the

⁷ Using this example, under the revised rule, the designated instruments and markets would be announced by Regulatory Circular. Thereafter, for a transaction in the QQQ options class to be adjusted or nullified due to an erroneous print in an underlying or related instrument that is later cancelled or corrected, the trade must be the result of: (i) an erroneous print in the underlying Nasdaq 100 ETF that is higher or lower than the average trade in the underlying Nasdaq 100 ETF on the primary market during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the ETF during the same period; or (ii) an erroneous print in the designated futures product overlying the Nasdaq 100 Index that is higher or lower than the average trade in the designated futures product on the designated market during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the futures product during the same period. See proposed changes to CBOE Rule 24.16(a)(3). For an options transaction to be adjusted or nullified due to an erroneous quote in an underlying or related instrument, an erroneous quote would occur when: (i) the underlying Nasdaq 100 ETF has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such ETF on the primary market during the time period encompassing two minutes before and after the dissemination of such quote; or (ii) the designated futures product overlying the Nasdaq 100 Index has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such futures product on the designated market during the period encompassing two minutes before and after the dissemination of such quote. See proposed changes to CBOE Rule 24.16(a)(4).

S&P Depository Receipts traded on the American Stock Exchange; and the S&P 500 futures contract traded on the Chicago Mercantile Exchange.⁸

The Exchange states that the proposed change is intended to address member feedback and to provide relief in those scenarios where an erroneous options transaction may occur as the result of an erroneous print or erroneous quote in markets other than the primary market for the underlying security. The Exchange believes the proposed change recognizes that market participants trading in the overlying index, ETF, and HOLDRS options may base their options prices on trading in various products and markets, while maintaining reasonable and objective criteria for these types of obvious error reviews.

Second, the proposal would eliminate the nullification and adjustment provision for trades below intrinsic value. CBOE Rule 24.16(a)(5) currently states that an obvious pricing error will be deemed to have occur when the transaction price of an option series is more than

⁸ Using this example, under the revised rule, the designated instruments and markets would be announced by Regulatory Circular. Thereafter, for a transaction in the OEX options class to be adjusted or nullified due to an erroneous print in an underlying or related instrument that is later cancelled or corrected, the trade must be the result of: (i) an erroneous report of the underlying S&P 100 Index value that is higher or lower than the average price in the index during a two-minute period before and after the erroneous report by an amount at least five times higher or lower than the difference between the highest and lowest index values during the same period; or (ii) an erroneous print in the S&P Depository Receipts or S&P 500 futures contract, as applicable, that is higher or lower than the average trade in the designated instrument during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the designated instrument during the same period. See proposed changes to CBOE Rule 24.16(a)(3). To be adjusted or nullified due to an erroneous quote in the underlying or related instrument, an erroneous quote would occur when the S&P Depository Receipts or S&P 500 futures contract, as applicable, has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such instrument on the relevant market during the time period encompassing two minutes before and after the dissemination of such quote. See proposed changes to CBOE Rule 24.16(a)(4) and note 5 supra.

\$0.10 below the intrinsic value of the same option. The purpose of deleting this provision is to account for circumstances under which options are correctly priced \$0.10 or more below the intrinsic value. For example, this might occur in options with underlying securities that are hard-to-borrow, extremely volatile issues where one market participant seeks to transfer the risk of selling or buying a security to other market participants by trading options, and options that are European-style exercise thus preventing exercise prior to expiration. Additionally, the Exchange notes that elimination of this provision is consistent with the Exchange's current rule for equity options, which does not have an obvious error review for trades below intrinsic value.⁹

Third, the proposal would modify the nullification provision for no bid series. Currently, the rule simply provides that electronic transactions in series that are quoted no bid on the Exchange are subject to nullification provided that at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid at the time of execution. Under the revised rule, additional criteria and clarifying language would be added. Specifically, an electronic transaction in a series quoted no bid on the Exchange would be subject to nullification provided: (i) the bid in that series immediately preceding the execution was, and for five seconds prior to the execution remained, zero; and (ii) at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid and offered at the same price or lower as that series at the time of execution. Thus, for example, if a trade occurs in the ABC 45 call option series when the series was quoted \$0.00 - \$0.10, the trade may be nullified if: (i) the bid was at \$0.00 for at least five seconds prior to the execution; and (ii) at least one call option

⁹ See CBOE Rule 6.25.

series in ABC with a strike below 45 (e.g., the ABC 30, 35 or 40 call option series) had a bid of \$0.00 and an offer of \$0.10 or less at the time of execution.

The revised no bid provision would provide that, when determining the Exchange's quotes in the relevant series, bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered. The revised rule would also provide that each group of series in an options class with a non-standard deliverable will be treated as a separate options class. Thus, for example, if due to a reorganization certain of the series in the ABC option class have a deliverable of 150 shares per options contract (as compared to the standard 100 shares per option contract), all ABC option series that are subject to the 150 contract delivery requirements would be considered separately from the ABC option series that are subject to the 100 contract delivery requirements for purposes of applying the no bid provision. Finally, the revised rule would clarify that the no bid provision is intended to apply to series quoted no bid on the Exchange (as opposed to series for which the national best bid is quoted no bid).¹⁰

The proposed changes to the no bid provision are intended to address the Exchange's experience in applying the provision to particular trading scenarios that have occurred. The Exchange believes that the additional criteria and clarifications are reasonable and objective, and would serve to better identify instances where the no bid provision is intended to apply.

¹⁰ Consistent with the existing provisions, for a nullification to be granted, any member or person associated with a member that believes it participated in a transaction that falls within the no bid series parameters must also satisfy the notification procedures set forth in paragraph (b) of CBOE Rule 24.16.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,¹¹ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹² in particular, in that it is designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts, 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.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were solicited or received by the Exchange with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

- A. by order approve the proposed rule change or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2007-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2007-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office

of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2007-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹³

Florence E. Harmon
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).