

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57286; File No. SR-CBOE-2007-122)

February 7, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change as Modified by Amendment No. 1 Thereto Amending its Obvious Error Rule for Options on Indices, ETFs, and HOLDRS

On October 31, 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend CBOE Rule 24.16 (“Rule 24.16” or “Rule”), 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”), to change the manner in which the Rule applies the obvious price error provision to transactions occurring as part of the Hybrid Opening System (“HOSS”) process. On December 14, 2007, the CBOE submitted Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on December 28, 2007.<sup>3</sup> The Commission received no comment letters on the proposal. This order approves the proposed rule change, as amended.

Currently, Rule 24.16 provides that an obvious price error will be deemed to have occurred when the execution price of a buy (sell) transaction is above (below) the fair market value of the option by at least the prescribed minimum error amount, as set forth in the Rule. For purposes of transactions occurring on HOSS, “fair market value” is currently defined as the

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

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

<sup>3</sup> Securities Exchange Act Release No. 57005 (December 20, 2007), 72 FR 73919.

midpoint of the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s). The Exchange proposes to revise the definition of fair market value to provide additional conditions that would apply during regular HOSS rotations and during HOSS rotations in index options series that are being used to calculate the final settlement price of volatility indexes on the final settlement day. According to CBOE, the additional conditions are intended to reasonably factor the amount of available liquidity into the fair market value calculation during these rotations.

With respect to regular HOSS rotations, the Exchange proposes to add a condition that the option contract quantity subject to nullification or adjustment cannot exceed the size of the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s). Any nullification or adjustment would occur on a pro rata basis and would take into account the overall size of the HOSS opening trade.

With respect to HOSS rotations in index options series that are used to calculate the final settlement price of a volatility index on the final settlement day, the Exchange proposes to add a condition that the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s) must be for at least the overall size of the HOSS opening trade. If the size of the quote is less than the overall size of the HOSS opening trade, then the obvious price error provision shall not apply.

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<sup>4</sup>

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<sup>4</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

and, in particular, the requirements of Section 6(b) of the Act<sup>5</sup> and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>6</sup> in that the proposal is designed to promote just and equitable principles of trade, remove impediments and perfect the mechanisms of a free and open market, and to protect investors and the public interest.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred and the process for reviewing such a determination should be based on specific and objective criteria and subject to specific and objective procedures.

The Commission believes that the Exchange's proposal to revise Rule 24.16 by modifying the manner in which the Rule applies its obvious price error provision to transactions in index options, options on ETFs, and options on HOLDERS that occur as part of the HOSS process during regular opening rotations and during opening rotations on the final settlement day for volatility indexes is appropriate. The proposal provides for an objective standard because in each of the foregoing situations, the fair market value calculation must take into account the size of the quote.

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<sup>5</sup> 15 U.S.C. 78f(b).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-CBOE-2007-122), as amended, is hereby approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>8</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>7</sup> 15 U.S.C. 78s(b)(2).

<sup>8</sup> 17 CFR 200.30-3(a)(12).