

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59060; File No. SR-CBOE-2008-115)

December 5, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Related to FLEX Options Expirations

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 November 19, 2008, 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 prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend its rules regarding permissible expiration dates for Flexible Exchange Options (“FLEX Options”).³ The text of the proposed rule change is

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ FLEX Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. FLEX Options can be FLEX Index Options or FLEX Equity Options. FLEX Index Options are index options that are subject to the FLEX rules in Chapters XXIVA or XXIVB of the CBOE Rules. FLEX Index Options Series may be approved and open for trading on any index that has been approved for Non-FLEX Options trading or for warrant trading on the Exchange. FLEX Equity Options are options on specified equity securities that are subject to the FLEX rules in Chapters XXIVA or XXIVB of the CBOE Rules. FLEX Equity Options may be on underlying securities that have been approved by the Exchange in accordance with CBOE Rule 5.3, which includes but is not limited to stock options and exchange-traded fund options. In addition, other products are permitted to be traded pursuant to the FLEX trading procedures. For example, credit options are eligible for trading as FLEX Options pursuant to the FLEX rules in Chapters XXIVA and XXIVB. See CBOE Rules 24A.1(e) and (f), 24A.4(b)(1) and (c)(1), 24B.1(f) and (g), 24B.4(b)(1) and (c)(1), and 28.19.

available on the Exchange's Website (<http://www.cboe.org/Legal>), CBOE, and at the Commission.

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 purpose of the filing is to modify the permissible expiration dates for FLEX Options. These options are governed by Exchange Chapters XXIVA and XXIVB. Under current CBOE Rules 24A.4 and 24B.4, FLEX Options may not expire on any business day that falls on, or within two business days of, a third Friday-of-the-month expiration day for any Non-FLEX Option (an "Expiration Friday").⁴ However, subject to certain aggregation requirements for cash settled options, the current FLEX Rules do permit the expiration of FLEX Options on the same day that Non-FLEX quarterly index options ("QIX") and Non-FLEX Weeklys Options expire.⁵

⁴ For example, under the current rule, a FLEX option could expire on the Tuesday before Expiration Friday, but could not expire on the Wednesday or Thursday before Expiration Friday. Similarly, a FLEX option could expire on the Wednesday after Expiration Friday, but could not expire on the Monday or Tuesday after Expiration Friday. This restriction is hereinafter referred to as the "three business day" expiration restriction.

⁵ Rules 24A.7(d) and 24B.7(d) provide that:

- (1) Commencing at the close of trading two business days prior to the last trading day of the calendar quarter, positions in P.M. Settled FLEX Index Options (*i.e.*, FLEX Index Options having an exercise settlement value determined by the level of the

The Exchange is now proposing to eliminate the expiration date restriction so that FLEX Options may expire on any business day. Although the expiration date restrictions would be eliminated, the Exchange notes that certain position limit and reporting requirements will continue to apply. FLEX Index Options overlying all industry indexes, all micro narrow-based indexes, and certain broad-based indexes remain subject to position limits under CBOE Rules 24A.7 and 24B.7. FLEX Index Options on certain other broad-based indexes (specifically the BXM, DJX, NDX, OEX, RUT, SPX, VIX, VXD, VXN, XEO, CBOE S&P 500 Three-Month Realized Variance and S&P 500 Three-Month Realized Volatility), and FLEX Equity Options are not subject to position limits but remain subject to reporting requirements under CBOE Rules 24A.7 and 24B.7. Additionally, all FLEX options remain subject to the position reporting requirements of CBOE Rule 4.13(a).⁶ Moreover, the Exchange and member organizations each

index at the close of trading on the last trading day before expiration) shall be aggregated with positions in Quarterly Index Options on the same index with the same expiration (“comparable QIX options”) and shall be subject to the position limits set forth in Rule 24.4, 24.4A or 24.4B, as applicable.

- (2) Commencing at the close of trading two business days prior to the last trading day of the week, positions in FLEX Options that are cash settled (i.e., FLEX Index Options or Credit Default Options) shall be aggregated with positions in Short Term Option Series on the same underlying (e.g., same underlying index as a FLEX Index Option) with the same means for determining exercise settlement value (e.g., opening or closing prices of the underlying index) and same expiration (“comparable Weekly options”) and shall be subject to the position limits set forth in Rule 24.4, 24.4A, 24.4B or 29.5, as applicable.

⁶ CBOE Rule 4.13(a) provides that “[i]n a manner and form prescribed by the Exchange, each member shall report to the Exchange, the name, address, and social security or tax identification number of any customer who, acting alone, or in concert with others, on the previous business day maintained aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of option contracts dealt in on the Exchange. The report shall indicate for each such class of options, the number of option contracts comprising each such position and, in the case of short positions, whether covered or uncovered.” For purposes of this Rule, the term “customer” in respect of any member includes “the member, any general or special partner of the member, any officer or director of the member, or any participant, as such, in any joint, group or syndicate

have the authority, pursuant to CBOE Rule 12.10, to impose additional margin as deemed advisable.

Beyond the above-described position limit and reporting requirements, for FLEX Options that expire on Expiration Friday, the proposed rule change includes an aggregation requirement under CBOE Rules 24A.7 and 24B.7 for position limit purposes. Specifically, for as long as the options positions remain open, positions in FLEX Options that expire on Expiration Friday shall be aggregated with positions in Non-FLEX Options on the same underlying (e.g., the same underlying security in the case of a FLEX Equity Option and the same underlying index in the case of a FLEX Index Option) (referred to as “comparable Non-FLEX Options”). Such FLEX Options and comparable Non-FLEX Options would be subject to the position limits that are applicable to the Non-FLEX Options.⁷ The aggregation requirement would apply to both cash and physically settled options.

In addition, in the case of FLEX Index Options only, the proposed rule change provides that FLEX Index Options expiring on or within two business days of an Expiration Friday may not have an exercise settlement value on the expiration date determined by reference to the

account with the member or with any partner, officer or director thereof.” CBOE Rule 4.13(d).

⁷ Thus, as soon as a FLEX Option position that expires on Expiration Friday is opened and as long as that position remains open, it would be subject to the position limit aggregation requirement at the position limits that are applicable to Non-FLEX Options. By comparison, the position limit aggregation requirement for FLEX Index Options that expire on the same date as Non-FLEX QIX or Weeklys Options only applies as of the close of trading two business days prior to the last trading day of the calendar quarter or week, as applicable. See note 5, supra; see also CBOE Rules 4.11, Position Limits (which contains position limits for Non-FLEX Equity Options); 24.4, Position Limits for Broad-Based Index Options; 24.4A, Position Limits for Industry Index Options; 24.4B, Position Limits for Options on Micro Narrow-Based Indexes as Defined Under Rule 24.2(d); and 29.5, Position Limits (which contains position limits for Credit Options).

closing price of the index.⁸ These limitations on exercise settlement value calculations are intended to serve as a safeguard against potential adverse effects that might be associated with triple witching.⁹ Once approved, the Exchange intends to evaluate the continued need for maintaining this safeguard and may consider proposing changes through a separate rule change filing.

In conjunction with the elimination of the expiration date restriction, the proposed rule change also states that, provided the options on an underlying security or index are otherwise eligible for FLEX trading, FLEX Options will be permitted in puts and calls that do not have the same exercise style, same expiration date and same exercise price as Non-FLEX Options that are already available for trading on the same underlying security or index. The proposed rule change also provides that FLEX Options will be permitted before (but not after) the options are listed for trading as Non-FLEX Options. Once and if an option series is listed for trading as a Non-FLEX Option series, (i) all existing open positions established under the FLEX trading procedures shall be fully fungible with transactions in the respective Non-FLEX Option series, and (ii) any further trading in the series would be as Non-FLEX options subject to the Non-FLEX trading procedures and rules.

For example, a FLEX Trader could establish a FLEX Option position in a European-style, am-settled SPX 1650 Call option series with an expiration of Aug 16, 2013 (which would

⁸ A closing exercise settlement value (also referred to as a “p.m. settlement”) is determined by reference to the reported level of the index as derived from the closing prices of the component securities. See CBOE Rules 24A.4(b)(2) and 24B.4(b)(2).

⁹ The expiration of the contracts for stock index futures, stock index options, and stock options all expire on the same days occurring on the third Friday of March, June, September, and December (which is referred to as “triple witching”). The Exchange’s proposed limitations on p.m. settlements would apply during triple witching expirations, as well as on all other Expiration Fridays.

be an Expiration Friday). In such an instance, once and if the Non-FLEX, European-style, unsettled SPX 1650 Call option series that expires on August 16, 2013 is listed for trading, the established FLEX Option position would be fully fungible with transactions in the Non-FLEX Option series. Any further trading in the series would be as Non-FLEX Options subject to the Non-FLEX trading procedures.

CBOE believes that expanding the eligible dates for FLEX expirations is important and necessary to the Exchange's efforts to create a product and market that provides members and investors interested in FLEX-type options with an improved but comparable alternative to the over-the-counter ("OTC") market in customized options, which can take on contract characteristics similar FLEX Options but are not subject to the same restrictions (such as the three business day expiration restriction or the p.m. settlement restriction). By expanding the eligible expiration dates for FLEX Options, market participants will now have greater flexibility in determining whether to execute their customized options in an exchange environment or in the OTC market. CBOE believes market participants benefit from being able to trade these customized options in an exchange environment in several ways, including, but not limited to the following: (1) enhanced efficiency in initiating and closing out positions; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of The Options Clearing Corporation ("OCC") as issuer and guarantor of FLEX Options. CBOE also believes this change is consistent and more competitive with the existing practice for trading flex-style options on futures exchanges.¹⁰

¹⁰ For example, expiration dates for Chicago Mercantile Exchange ("CME") flex options may be specified for any exchange business day up to and including the day of determination of the final settlement price of the underlying futures contract. In addition, CME flex options are permitted in puts and calls that do not have the same underlying futures contract, same strike price, same exercise style, and same expiration date as standard listed options that are already available for trading. Trading in standard options

CBOE notes that when the FLEX Option rules were initially proposed and approved almost sixteen years ago, the Exchange was uncertain what market impacts, if any, excessive FLEX positions would have on the market or on firms.¹¹ To minimize the risk of adverse market effects, at the time the FLEX rules were first introduced the Exchange put in place certain position limit boundaries (which have been modified over time) and the requirement that the FLEX expiration date be no closer than three business days from any Non-FLEX Option Expiration Friday. However, in light of the Exchange's experience in trading FLEX Options to date, specifically with respect to the diversity in FLEX Option trading, the relatively small percentage FLEX Options trading compared to overall trading on the Exchange, and the lack of market disruptions or problems caused by or on existing FLEX Option expirations, CBOE no longer believes that the three business day expiration restriction is necessary to insulate Non-FLEX expirations from the potential adverse market impacts of FLEX expirations.¹² To the

under certain flexible trading procedures is permitted prior to the listing of such standard options. Once and if the standard options are listed, all existing open positions established under the flexible trading procedures are fully fungible with transactions in the standard option series, and any further trading in the series is as standard options subject to the standard option trading procedures. See, e.g., CME Rules 351A.31A and 357A.31A, and CME Equity Futures and Options 2007 Information Guide at pages 46-47, located at <http://www.cme.com/files/EquityIndexManual.pdf>.

¹¹ See Securities Exchange Act Release Nos. 31361 (October 27, 1992) 57 FR 52655 (November 4, 1992)(SR-CBOE-92-17)(notice of filing of proposed rule change relating to Flexible Exchange Options) and 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993)(Order approving SR-CBOE-92-17). At the time of the proposal, the Exchange also anticipated that there would be limited secondary trading in any FLEX Option series having a particular expiration date due to the diversity inherent in FLEX Options and that FLEX expiration concentrations should be rare. These observations appear to be accurate for the trading in FLEX Options to date.

¹² In further support of its proposal, the Exchange also notes that it is not aware of any market disruptions or problems caused by customized options in the OTC or futures markets that expire on or near Expiration Friday. Moreover, to the extent there may be a risk of adverse market effects attributable to options that would otherwise be traded in a non-transparent fashion in the OTC market, CBOE believes that such risk would be lessened by making these customized options eligible for trading in an exchange

contrary, CBOE believes that the restriction actually places the Exchange at a competitive disadvantage to its OTC and futures counter-parts in the market for customized options, and unnecessarily limits market participants' ability to trade in an exchange environment that offers the added benefits of transparency, price discovery, liquidity, and financial stability.

Although the expiration date restrictions would be eliminated, the Exchange notes that the above-described position limit and reporting requirements will continue to apply. Moreover, the Exchange and member organizations each have the authority, pursuant to CBOE Rule 12.10, to impose additional margin as deemed advisable. CBOE believes these existing safeguards serve sufficiently to help monitor open interest in FLEX Option series and significantly reduce any risk of adverse market effects that might occur as a result of large FLEX exercises in FLEX Option series that expire near Non-FLEX expirations. Beyond this, however, CBOE is also proposing to impose the above-described aggregation requirement for FLEX Options that have the same expiration as comparable Non-FLEX Options at the position limit amounts that are applicable to the Non-FLEX Options, and the above-described limitations on FLEX Index Option p.m. settlements. Further, it is anticipated that there would continue to be limited secondary trading in any FLEX Option series having a particular expiration date due to the diversity inherent in FLEX Options and that FLEX expiration concentrations should be rare.

In proposing this change to the eligible FLEX expiration dates, CBOE is cognizant of the need for market participants to have substantial options transaction capacity and flexibility to hedge their substantial investment portfolios, on the one hand, and the potential for adverse effects on the market or on firms that might be attributable to excessive FLEX positions which expire near or at the expiration date for Non-FLEX Options, on the other hand. CBOE is also

environment because of the added transparency, price discovery, liquidity, and financial stability available.

cognizant of the OTC market, in which no position limit, expiration date and p.m. settlement restrictions apply. In light of these considerations,¹³ CBOE believes this change is appropriate and reasonable and that it will provide market participants with additional flexibility to determine expiration dates and choice of venue that best comport with investors' particular needs.

Finally, the Exchange has confirmed with the OCC that OCC can configure its systems to support the expiration of FLEX Options on any business day.

2. Statutory Basis

By expanding permissible expiration dates for FLEX Options, the Exchange believes the proposed rule change is consistent with Section 6(b) of the Act¹⁴ in general and furthers the objectives of Section 6(b)(5) of the Act¹⁵ in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. The proposed rule change would provide members and investors with additional opportunities to trade customized options in an exchange environment, and investors would benefit as a result.

¹³ Besides the fact that OTC customized options are not subject to a restriction on expiration date and p.m. settlement, the Exchange notes that FLEX Options can be designated as American-style (which can be exercised at any time up to the day before expiration) or European- or European-Capped-style (which can be exercised only at expiration). Though it is possible for FLEX Options that are American-styled to be exercised any time, including during the three business day expiration restriction period, there have been no market disruptions or problems caused by the early exercise of American-style FLEX options at or near Non-FLEX expirations. In addition, it is not uncommon for similar products across markets to have the same expiration dates. For example, the contracts for stock index futures, stock index options, and stock options all expire on the same triple witching days occurring on the third Friday of March, June, September, and December.

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(5).

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 that is 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 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 self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

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-2008-115 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission,

100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2008-115. 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 a.m. and 3:00 p.m. 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-2008-115 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.¹⁶

Florence E. Harmon

Acting Secretary

¹⁶ 17 CFR 200.30-3(a)(12).