

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57161; File No. SR-CBOE-2006-36)

January 16, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change as Modified by Amendments No. 1 and 2 Thereto Regarding FLEX Equity Option Opening Transactions

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 14, 2006, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”), filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by CBOE. On December 24, 2007, the Exchange filed Amendments No. 1³ and 2⁴ 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

CBOE proposes to amend its rules regarding the minimum value size for an opening transaction in FLEX Equity Option series on a pilot program basis. The text of the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced the original filing in its entirety.

⁴ Amendment No. 2 replaced Amendment No. 1 in its entirety. The purpose of Amendment 2 was to (i) modify the proposed formula contained in Rule 24A.4 applicable to determining the minimum value size for FLEX Equity Options in new series to change the minimum contract component from the originally proposed 100 contracts to 150 contracts, and make this change applicable on a 1-1/2-year pilot program basis; (ii) propose changes to the formula applicable to determining the minimum value size in currently-opened series; (iii) include corresponding amendments to Rule 24B.4; and (iv) provide additional information in the Purpose section of the filing.

change is available on the Exchange's Web site (<http://www.cboe.org/Legal>), at the Office of the Secretary, CBOE and at the Commission's Public Reference Room.

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

In its filing with the Commission, CBOE 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 those 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 minimum value size for an opening transaction (other than FLEX Quotes responsive to a FLEX Request for Quotes) in any FLEX Equity Option⁵ series in which there is no open interest at the time the Request for Quotes is submitted. Currently, the minimum opening transaction value size in the case of a FLEX Equity Options series is the lesser of (i) 250 contracts or (ii) the number of contracts overlying \$1 million in the underlying securities.⁶ The Exchange proposes to reduce the "250 contracts" component to "150 contracts;" the \$1 million underlying value component will continue to apply unchanged.⁷

⁵ FLEX Equity Options are flexible exchange-traded options contracts which overlie equity securities. FLEX Equity Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices.

⁶ Under this formula, an opening transaction in a FLEX Equity series in a stock priced at \$40 or more would reach the \$1 million limit before it would reach the contract size limit, i.e., 250 contracts times the multiplier (100) times the stock price (\$40) equals \$1 million in underlying value. For a FLEX Equity series in a stock priced at less than \$40, the 250 contract size limit applies.

The proposal would become effective on a pilot program basis for a period of 1 ½ years. If the Exchange were to propose an extension, expansion, or permanent implementation of the program, the Exchange would submit, along with a filing proposing any necessary amendments to the program, a pilot program report. The report would include, for the period during which the program was in effect: (i) data and analysis on the open interest and trading volume in FLEX Equity Options for which series were opened with a minimum opening size of 150 to 249 contracts and less than \$1 million in underlying value; and (ii) analysis on the types of investors that initiated opening FLEX Equity Options transactions (i.e., institutional, high net worth, or retail, if any). The report would be submitted to the Commission at least ninety days prior to the expiration date of the 1 ½ year pilot program.

The Exchange believes that the reduction of the minimum value size for opening a series in the manner proposed provides FLEX-participating members with greater flexibility in structuring the terms of FLEX Equity Options that best comports with their and their customers' particular needs. The Exchange notes that the opening size requirement for FLEX Equity Options was originally put in place to limit participation in FLEX Equity Options to sophisticated, high net worth investors rather than retail investors.⁸ Based on the Exchange's experience to date with such options, it appears that the existing 250 contract component is too large to accommodate the needs of FLEX-participating members and their institutional and high

⁷ Under this proposed formula, an opening transaction in a FLEX Equity series in a stock priced at approximately \$66.67 or more would reach the \$1 million limit before it would reach the contract size limit, i.e., 150 contracts times the multiplier (100) times the stock price (\$66.67) equals just over \$1 million in underlying value. For a FLEX Equity series in a stock priced at less than \$66.67, the 150 contract size limit would apply.

⁸ The existing customer base for FLEX Options includes both institutional investors and high net worth individuals.

net worth customers and thus has become overly restrictive. In particular, the Exchange has recently received numerous requests from broker-dealers representing institutional investors that the minimum value size for opening transactions be reduced.

In proposing the reduction of the 250 contract component to 150 contracts, CBOE is cognizant of the desire to continue to provide the requisite amount of investor protection that the minimum opening size requirement was originally designed to achieve, on the one hand, and the need for market participants to have the flexibility to serve their customers' particular investment needs, on the other hand. As discussed further below, CBOE is also aware of the over-the-counter ("OTC") market in customized options, which can take on contract characteristics similar to FLEX Options but for which similar opening size restrictions do not apply. In light of these considerations, CBOE believes it is appropriate to modify the FLEX Equity Option minimum opening size requirement in the manner proposed. By reducing the 250 contract component to 150 contracts, the Exchange believes FLEX-participating members could better serve the needs of investors, while maintaining a requirement substantial enough to limit participation to investors who have adequate resources, thereby continuing to provide the requisite amount of investor protection that the opening size requirement was originally designed to achieve. Also, limiting the term of the program to a period of 1-1/2 years would give the Exchange time to consider whether it should request that the program should be extended, expanded, and/or made permanent. If so, CBOE would seek Commission approval.

In further support of its proposal, the Exchange notes that the minimum value size for currently-opened FLEX Equity Option series is already set at 100 contracts, and the minimum size for FLEX Quotes entered in response to a FLEX Request for Quotes is set at 25 contracts

(whether in a new series or in a currently-opened series).⁹ If FLEX Equity Option transactions can occur in increments of 100 or more contracts in subsequent opening transactions, the Exchange believes it is reasonable to permit the initial series opening transaction size to be 150 contracts (or \$1 million in underlying value, whichever is less).

The Exchange also believes that modifying the minimum opening transaction value size in this way will further broaden the base of institutional investors that use FLEX Equity Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options which, as indicated above, can take on contract characteristics similar to FLEX Options but for which similar opening size restrictions do not apply. By reducing the minimum opening size requirements for FLEX Equity Options, market participants will 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, enhanced efficiency in initiating and closing out positions; increased market transparency; and heightened contra-party creditworthiness due to the role of The Options Clearing Corporation as issuer and guarantor of FLEX Options.

⁹ Specifically, the minimum value size for a transaction in any currently-opened FLEX Equity Option series is 100 contracts in the case of opening transactions and 25 contracts in the case of closing transactions (or any lesser amount in a closing transaction that represents the remaining underlying size, whichever is less). Additionally, the minimum value size for a FLEX Quote entered in response to a Request for Quotes in FLEX Equity Options is the lesser of 25 contracts or the remaining underlying size in a closing transaction. See Exchange Rules 24A.4(a)(4)(iii) – (iv) and 24B.4(a)(5)(iii) – (iv). A “FLEX Quote” refers to (i) FLEX bids and offers entered by Market-Makers and (ii) orders to purchase and orders to sell FLEX Options entered by Exchange members other than Market-Makers, in each case in response to a Request for Quotes. See CBOE Rules 24A.1(h) and 24B.1(k).

Finally, the Exchange is also proposing to modify the minimum value size for an opening transaction in a currently-opened FLEX Equity series (other than FLEX Quotes responsive to a FLEX Request for Quotes). As discussed above, presently, the minimum transaction value size for an opening transaction in a currently-opened series is 100 contracts. The Exchange is proposing to modify the minimum size formula to the lesser of (i) 100 contracts or (ii) the number of contracts overlying \$1 million in the underlying securities. This change would only impact those FLEX Equity series in which the underlying stock is trading at \$100 or more.¹⁰

The FLEX minimum size requirements have generally provided that the minimum size for subsequent opening transactions in a currently-opened series is smaller than the minimum size needed to initially open the series. Therefore, Exchange believes that this change is necessary for there to be consistency between the minimum size requirements for new series and currently-opened series when the underlying stock is trading at \$100 or more. For example, a new FLEX Equity series in a stock trading at \$110 could open with an initial transaction size of 91 contracts, i.e., 91 contracts times the multiplier (100) times the stock price (\$110) equals just over \$1 million in underlying value. Once the series is opened, absent the proposed change, any further opening transactions would require a minimum contract size of 100 contracts. However, if the initial series opening can occur with a 91 contract transaction, the Exchange believes that it is reasonable to permit the size of subsequent opening transactions in the series to be for 91 contracts.

¹⁰ Under this proposed formula, a transaction in a currently-opened FLEX Equity series in a stock priced at \$100 or more would reach the \$1 million limit before it would reach the contract size limit, i.e., 100 contracts times the multiplier (100) times the stock price (\$100) equals \$1 million in underlying value.

2. Statutory Basis

By providing FLEX-participating members and their customers greater flexibility to trade FLEX Equity Options by lowering from 250 to 150 the minimum number of contracts required to open a series, the Exchange believes the proposed rule change is consistent with Section 6(b) of the Act¹¹ in general and furthers the objectives of Section 6(b)(5) of the Act¹² 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, in general, protect investors and the public interest.

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

CBOE 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 CBOE consents, the Commission will:

- (A) by order approve such proposed rule change, or

¹¹ 15 U.S.C. 78(f)(b).

¹² 15 U.S.C. 78(f)(b)(5).

- (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-2006-36 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-2006-36. 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 CBOE. 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-2006-36 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.¹⁷

Florence E. Harmon
Deputy Secretary