

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63202; File No. SR-CBOE-2010-080)

October 28, 2010

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Trade Options on Leveraged Exchange-Traded Notes and to Broaden the Definition of "Futures-Linked Securities"

I. Introduction

On August 31, 2010, the Chicago Board Options Exchange ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1)<sup>1</sup> of the Securities Exchange Act of 1934 ("Act"), and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to: (a) permit the trading of options on leveraged (multiple or inverse) exchange-traded notes ("ETNs"), and (b) broaden the definition of "Futures-Linked Securities." On September 9, 2010, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on September 16, 2010.<sup>3</sup> The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change as modified by Amendment No. 1.

II. Description of the Proposal

The purpose of CBOE's proposed rule change is to amend Interpretation and Policy .13 to Rule 5.3 to: (a) permit the trading of options on leveraged (multiple or inverse) ETNs,<sup>4</sup> and (b) broaden the definition of "Futures-Linked Securities."

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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> See Securities Exchange Release No. 62880 (September 9, 2010), 75 FR 56628.

<sup>4</sup> ETNs are also known as "Index-Linked Securities," which are designed for investors who desire to participate in a specific market segment by providing exposure to one or more

### Leveraged ETN Options

Multiple leveraged ETNs seek to provide investment results that correspond to a specified multiple of the percentage performance of a particular Reference Asset on a given day. Inverse leveraged ETNs seek to provide investment results that correspond to the inverse (opposite) of the percentage performance of a particular Reference Asset by a specified multiple on a given day. Multiple leveraged ETNs and inverse leveraged ETNs differ from traditional ETNs in that they do not merely correspond to the performance of a given Reference Asset, but rather attempt to match a multiple or inverse of a Reference Asset's performance.

The Barclays Long B Leveraged S&P 500 TR ETN ("BXUB"), the Barclays Long C Leveraged S&P 500 TR ETN ("BXUC") and the UBS AG 2x Monthly Leveraged Long Exchange Traded Access Securities ("E-TRACS") linked to the Alerian MLP Infrastructure Index due July 9, 2040 ("MLPL") currently trade on the NYSE Arca Stock Exchange and are examples of multiple leveraged ETNs. In addition, the Barclays ETN + Inverse S&P 500 VIX Short-Term Futures ETN ("XXV") currently trades on the NYSE Arca Stock Exchange and is an example of an inverse leveraged ETN.

Currently, Interpretation and Policy .13 to Rule 5.3 provides that securities deemed appropriate for options trading shall include shares or other securities ("Equity Index-Linked Securities," "Commodity-Linked Securities," "Currency-Linked Securities," "Fixed Income Index-Linked Securities," "Futures-Linked Securities," and "Multifactor Index-Linked Securities," collectively known as "Index-Linked Securities") that are principally traded on a

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identifiable underlying securities, commodities, currencies, derivative instruments, or market indexes of the foregoing. Index-Linked Securities are non-convertible debt of an issuer that have a term of at least one year but not greater than thirty years. Index-Linked Securities are traded as a single, exchange-listed security. As such, rules pertaining to the listing and trading of standard equity options apply to Index-Linked Securities.

national securities exchange and an "NMS Stock" (as defined in Rule 600 of Regulation NMS under the Securities Exchange Act of 1934), and represent ownership of a security that provides for the payment at maturity, as described below:

- Equity Index-Linked Securities are securities that provide for the payment at maturity of a cash amount based on the performance of an underlying index or indexes of equity securities ("Equity Reference Asset");
- Commodity-Linked Securities are securities that provide for the payment at maturity of a cash amount based on the performance of one or more physical commodities or commodity futures, options on commodities, or other commodity derivatives or Commodity-Based Trust Shares or a basket or index of any of the foregoing ("Commodity Reference Asset");
- Currency-Linked Securities are securities that provide for the payment at maturity of a cash amount based on the performance of one or more currencies, or options on currencies or currency futures or other currency derivatives or Currency Trust Shares (as defined in Interpretation and Policy .06 to this Rule 5.3), or a basket or index of any of the foregoing ("Currency Reference Asset");
- Fixed Income Index-Linked Securities are securities that provide for the payment at maturity of a cash amount based on the performance of one or more notes, bonds, debentures or evidence of indebtedness that include, but are not limited to, U.S. Department of Treasury securities ("Treasury Securities"), government-sponsored entity securities ("GSE Securities"), municipal securities, trust preferred securities, supranational debt and debt of a foreign country or a subdivision thereof or a basket or index of any of the foregoing ("Fixed Income Reference Asset");

- Futures-Linked Securities are securities that provide for the payment at maturity of a cash amount based on the performance of an index of (a) futures on Treasury Securities, GSE Securities, supranational debt and debt of a foreign country or a subdivision thereof, or options or other derivatives on any of the foregoing; or (b) interest rate futures or options or derivatives on the foregoing in this subparagraph (b); or (c) CBOE Volatility Index (VIX) futures ("Futures Reference Asset"); and
- Multifactor Index-Linked Securities are securities that provide for the payment at maturity of a cash amount based on the performance of any combination of two or more Equity Reference Assets, Commodity Reference Assets, Currency Reference Assets, Fixed Income Reference Assets, or Futures Reference Assets ("Multifactor Reference Asset").

For purposes of Interpretation and Policy .13 to this Rule 5.3, Equity Reference Assets, Commodity Reference Assets, Currency Reference Assets, Fixed Income Reference Assets, Futures Reference Assets together with Multifactor Reference Assets, collectively are referred to as "Reference Assets."

In addition, Index-Linked Securities must meet the criteria and guidelines for underlying Securities set forth in Interpretation and Policy .01 to this Rule 5.3; or the Index-Linked Securities must be redeemable at the option of the holder at least on a weekly basis through the issuer at a price related to the applicable underlying Reference Asset. In addition, the issuing company is obligated to issue or repurchase the securities in aggregation units for cash, or cash equivalents, satisfactory to the issuer of Index-Linked Securities which underlie the option as described in the Index-Linked Securities prospectus.

The Exchange proposes to amend Interpretation and Policy .13 to Rule 5.3 to expand the type of Index-Linked Securities that may underlie options to include leveraged (multiple or inverse) ETNs. To affect this change, the Exchange proposes to amend Rule 5.3.13 by adding the phrase, "or the leveraged (multiple or inverse) performance" to each of the subparagraphs ((A) through (F)) in that section which set forth the different eligible Reference Assets.

The Exchange's current continuing listing standards for ETN options will continue to apply. Specifically, under Interpretation and Policy .16 to Rule 5.4, ETN options shall not be deemed to meet the Exchange's requirements for continued approval, and the Exchange shall not open for trading any additional series or option contracts of the class covering such Securities whenever the underlying Securities are delisted and trading in the Securities is suspended on a national securities exchange, or the Securities are no longer an "NMS Stock" (as defined in Rule 600 of Regulation NMS under the Securities Exchange Act of 1934). In addition, the Exchange shall consider the suspension of opening transactions in any series of options of the class covering Index-Linked Securities in any of the following circumstances: (1) the underlying Index-Linked Security fails to comply with the terms of Interpretation and Policy .13 to Rule 5.3; (2) in accordance with the terms of Interpretation and Policy .01 to Rule 5.4, in the case of options covering Index-Linked Securities when such options were approved pursuant to Interpretation and Policy .13 to Rule 5.3, except that, in the case of options covering Index-Linked Securities approved pursuant to Interpretation and Policy .13(3)(B) to Rule 5.3 that are redeemable at the option of the holder at least on a weekly basis, then option contracts of the class covering such Securities may only continue to be open for trading as long as the Securities are listed on a national securities exchange and are "NMS" stocks as defined in Rule 600 of Regulation NMS; (3) in the case of any Index-Linked Security trading pursuant to Interpretation

and Policy .13 to Rule 5.3, the value of the Reference Asset is no longer calculated; or (4) such other event shall occur or condition exist that in the opinion of the Exchange makes further dealing in such options on the Exchange inadvisable. Expanding the eligible types of ETNs for options trading under Interpretation and Policy .13 to Rule 5.3 will not have any effect on the rules pertaining to position and exercise limits<sup>5</sup> or margin.<sup>6</sup>

The Exchange has represented that its existing surveillance procedures applicable to trading in options are adequate to properly monitor the trading in leveraged (multiple and inverse) ETN options.

It is expected that The Options Clearing Corporation will seek to revise the Options Disclosure Document ("ODD") to accommodate the listing and trading of leveraged (multiple and inverse) ETN options.

#### Definition of "Futures-Linked Securities"

The second change being proposed by the Exchange's filing is to amend the definition of "Futures-Linked Securities" set forth in Rule 5.3.13(1)(E). Rule 5.3 sets forth generic listing criteria for securities that may serve as underlyings for listed options. Currently, the definition of "Futures-Linked Securities" is limited to securities that provide for the payment at maturity of a cash amount based on the performance of an index of (a) futures on Treasury Securities, GSE Securities, supranational debt and debt of a foreign country or a subdivision thereof, or options or other derivatives on any of the foregoing; or (b) interest rate futures or options or derivatives on the foregoing in this subparagraph (b); or (c) CBOE Volatility Index (VIX) futures. The Exchange is proposing to revise the definition of "Futures-Linked Securities" to provide that they are securities that pay at maturity a cash amount based on the performance or the leveraged

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<sup>5</sup> See Rules 4.11, Position Limits, and 4.12, Exercise Limits.

<sup>6</sup> See Rule 12.3, Margin Requirements.

(multiple or inverse) performance of an index or indexes of futures contracts or options or derivatives on futures contracts ("Futures Reference Asset"). All ETNs eligible for options trading must still be principally traded on a national securities exchange and an "NMS Stock."

### III. Commission Findings

After careful consideration, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,<sup>7</sup> and in particular, the requirements of Section 6(b) of the Act.<sup>8</sup> Specifically, the Commission finds that the proposed rule changes are consistent with Section 6(b)(5) of the Act,<sup>9</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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.

#### Leveraged ETN Options

The Commission notes that the Exchange has represented that, similar to its imposition of higher margin requirements for options on leveraged ETFs,<sup>10</sup> the Exchange will impose higher margin requirements for leveraged ETNs, as allowed under CBOE Rules 12.3(h) and 12.10. The Exchange will also issue a Regulatory Circular announcing the new margin requirements prior to listing and trading options on leveraged ETNs.

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

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> See CBOE Regulatory Circulars RG09-97 (August 31, 2009), RG09-132 (November 20, 2009). See also FINRA Regulatory Notices 09-53 (August 2009), 09-65 (November 2009).

In addition, pursuant to the proposed rule change, the Exchange represented that the current listing standards for ETN options will continue to apply. The Exchange has also represented that its existing surveillance procedures applicable to trading options are adequate to properly monitor trading of options on leveraged ETNs.

The Commission believes that these representations are adequate to protect investors. Furthermore, the Commission believes that the ability to trade options on leveraged ETNs will provide investors with additional risk management tools. Therefore, the Commission believes that this proposed rule change is appropriate.

#### Broaden the Definition of "Futures-Linked Securities"

The Commission believes that this proposal will provide a more efficient process for the Exchange to list and trade options on ETNs. The Exchange will be able to list and trade options overlying newly introduced ETNs that do not fall within the current definition of "Futures-Linked Securities," without first filing a rule change proposal with the Commission to change the definition of "Futures-Linked Securities" to include each specific new product. The Commission notes that all ETNs that underlie options traded on the Exchange must still be principally traded on a national securities exchange and must be an "NMS stock." In addition, pursuant to the proposed rule change, the Exchange represented that the current listing standards for options on ETNs will continue to apply to options on ETNs that fall within the proposed definition of "Futures-Linked Securities." The Exchange has also represented that its existing surveillance procedures applicable to trading options are adequate to properly monitor trading of options on ETNs. Therefore, the Commission believes that this proposed rule change is appropriate.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that the propose rule change (SR-CBOE-2010-080), as modified by Amendment No. 1, be, and is hereby, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>12</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>11</sup> 15 U.S.C. 78s(b)(2).

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