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Via Electronic Submission

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Comment Letter to SR-NYSEAmex-2010-14¹

Dear Ms. Morris:

Chicago Board Options Exchange, Incorporated ("CBOE") hereby submits comments on the proposed rule change by NYSE Amex, LLC ("NYSE Amex") to (1) eliminate position and exercise limits for all options on the DIAMONDS Trust ("DIA"), the Standard and Poor's Depository Receipts Trust 1 ("SPY"), the iShares Russell 2000 Index Fund ("IWM"), and the PowerShares QQQ Trust ("QQQQ"), (2) limit 1,000 share option contracts ("Jumbo Options") to DIA, SPY, IWM and QQQQ and to also restrict Jumbo Options to only those ETF options for which there are no position and exercise limits, (3) permit strike prices for Jumbo Options to be set at 1/100th of the total contract deliverable value, and (4) permit bids and offers for Jumbo Options to be set at 1/100th of the total value of the contract.

As discussed in detail below, CBOE believes that the NYSE Amex proposal to introduce Jumbo Options raises significant issues that warrant either disapproval of the proposal by the Securities and Exchange Commission ("SEC") or substantial alteration of the filing to address these issues. Specifically, the proposal, if approved, will result in the exemption of the proposed products from price protection requirements and will result in a lack of consistent treatment by the SEC of rule proposals from different exchanges that raise virtually identical issues. The proposal, if approved, will also result in investor confusion and is inconsistent with the Options Disclosure Document ("ODD"). Finally, NYSE Amex's request to eliminate position and exercise limits for options on DIA, SPY, IWM and QQQQ is premised on a rationale that is erroneous and misplaced and is at odds with the SEC's longstanding historical approach of increasing limits in stages to gauge market impact.

¹ See Securities Exchange Act Release No. 61535 (February 18, 2010), 75 FR 8774 (February 25, 2010) (noticing SR-NYSEAmex-2010-14).

I. Proposal to Trade Jumbo Options on DIA, SPY, IWM and QQQQ

Failure to Address Price Protection; Inconsistent Treatment

Consistent treatment by the SEC is an important factor on which exchanges rely and depend in the regulatory process. NYSE Amex's proposal raises market structure issues that are identical to concerns raised by SEC staff in rejecting and forcing a draconian alteration to a CBOE proposed rule change with respect to CBOE S&P 500 BuyWrite Index options ("BXM" options). In that filing, CBOE originally proposed to trade both full and reduced value BXM options. When reviewing the CBOE filing, the SEC staff raised price protection concerns in objecting to the use of two sizes of options on the same instrument. Specifically, SEC staff expressed concern that a trade could occur in the full (or reduced) contract that would trade through the book of the reduced (or full) contract. SEC staff objected so strongly to CBOE's proposal on these grounds that CBOE was forced to change its proposed rule to offer only reduced value BXM options.²

While CBOE's proposal involved broad-based index options and the NYSE Amex involves ETF options, the NYSE Amex proposal raises **identical** market structure concerns. If these concerns were serious and great enough to lead the SEC staff to prevent CBOE from introducing both of its BXM products, they likewise must prevent the changes that NYSE Amex proposes. If, however, the SEC is considering reversing its position and exempting the proposed products from price protection, such a significant policy change should be subject to a broader market structure release seeking industry comment.³ Unfortunately, the NYSE Amex proposal is styled as a proposal to change position limits for certain exchange traded funds when, in fact, it also raises broader price protection issues. Important policy developments concerning market structure should be noticed for what they are and subject to a full notice and comment period, and not for the minimum time required (15 days) as was done here.

As to the trade-through concern the SEC staff raised with respect to CBOE's filing, the same concern applies to the NYSE Amex filing. Below is an example that builds on the example supplied by NYSE Amex, assuming that the SEC requires price protection between the proposed standard and Jumbo options.

Standard SPY Option		Jumbo SPY Option	
JUN 45 call	3.20 – 3.23	JUN 450 call	32.00 – 32.30

² See Securities Exchange Act Release No. 58207 (July 22, 2008), 73 FR 43963 (July 29, 2008) (SR-CBOE-2008-26). In addition, around this same time, the Philadelphia Stock Exchange, Inc. ("Phlx") formally filed a proposal to trade options on ETFs and on Trust Issued Receipts, each with a unit of trading of 1,000 shares. CBOE understands that Phlx withdrew that filing because it presented the same price protection issues to SEC staff. See SR-Phlx-2008-11 (filed on 2/08/08).

³ CBOE believes that, at a minimum, an amendment to or exemption from the Options Linkage Plan would be required pursuant to Rule 608 of Regulation NMS, which has not been done.

Based on the above hypothetical market for the June 45/450 call, if a customer submits an order to sell 10 standard SPY calls at \$3.21 per share, the new market for standard SPY options would become 3.20 – 3.21. NYSE Amex's filing fails to address whether the new market for standard SPY options would also become the new market for Jumbo SPY Options, and, if so, how that would be accomplished. In addition, NYSE Amex fails to address how it would handle the situation in which an order subsequently comes in and trades at \$32.30 for a Jumbo SPY Option and whether that transaction would constitute a trade-through with respect to the standard SPY option quote at 3.21. In other words, the NYSE Amex fails to address whether price protection would apply across both standard and Jumbo options contracts, and if not, why not.

Additionally, the minimum increment for bids and offers for standard DIA, SPY, IWM and QQQQ options is \$0.01. NYSE Amex fails to address the minimum increment size for bids and offers for Jumbo ETF Options. The possibility exists that Jumbo Options and regular size options could be quoted and traded at different price points. Therefore, the price protection concerns that the SEC staff raised to block CBOE's BXM filing are not addressed nor can they be remedied in the NYSE Amex filing.

The issues addressed above are no different than the concerns raised by SEC staff with respect to the CBOE proposal for BXM options. Consistency in treatment by the SEC of identical issues raised by proposed rule changes of two or more exchanges is critical to the legitimacy and credibility of the rule filing review process. There have been no developments in the options markets since our proposal to trade full and reduced value BXM options only a short time ago that warrant different SEC treatment to the NYSE Amex proposal than to our BXM option proposal. Thus, unless the SEC can identify a highly compelling and justifiable reason for reversing its approach on these issues, the SEC should not approve this part of the rule filing. If however, the SEC is considering overriding its earlier market structure concerns, such a position presents a significant policy shift that should be addressed through a release seeking industry comment. Otherwise, the unequal treatment between the CBOE and NYSE Amex rule proposals and the swift reversal in SEC viewpoint on identical market structure issues would inject an arbitrariness and unfairness in the rule review process that would be of serious concern.

Investor Confusion; Inconsistency with the ODD

The NYSE Amex filing proposes to designate DIA, SPY, IWM and QQQQ ETFs as eligible to serve as the underlying interest for options that have a 1,000 share unit of trading and to also restrict Jumbo Options to only those ETF options for which there are no position and exercise limits.⁴ NYSE Amex proposes to revise the contract terms of Jumbo Options by: (1) permitting strike prices for Jumbo Options to be set at 1/100th of

⁴ NYSE Amex previously received Commission approval to list option contracts covering 100 fund shares, 1,000 fund shares or both. When that proposal was originally approved, it was not limited to any specific ETFs and the unit of trading designation was not contained in any rule text. See Securities Exchange Act Release Nos. 40157 (July 1, 1998), 63 FR 37426 (July 10, 1998) (SR-Amex-96-44).

the total contract deliverable value, and (2) permitting bids and offers for Jumbo Options to be set at $1/100^{\text{th}}$ of the total value of the contract. The result of these proposed changes would be that the exercise prices and premiums for the Jumbo Options would be ten times the standard size ETF option strikes and premiums. (This is referred to below as the "per 10 share" convention.) NYSE Amex states that these proposed changes would be made to avoid investor confusion with standard options on the same ETF. CBOE believes that, to the contrary, the proposed changes will have the opposite effect and create investor confusion.

In establishing a "per 10 share" convention for setting exercise prices and quoting premiums, NYSE Amex would in effect be creating a "virtual" or "synthetic" underlying security, with each unit equal to ten of the actual ETF shares.⁵ This virtual security would, of course, be neither issued nor available for purchase in the marketplace. From an operational standpoint, the NYSE Amex proposal would require that values of this virtual security would have to be disseminated to the marketplace. These values would be needed for, among other things, margin calculations and use by those who wish to engage in covered call writing transactions and need to value the "ETF" leg of their positions. CBOE believes the use of the "per 10 share" convention will result in confusion with respect to the transaction costs associated with delivering ETFs for purposes of trading out of positions resulting from exercises of the jumbo ETFs, since the "virtual" security value could obscure the number of shares that would be received or delivered in settlement of an exercise, so that the recipient of units could be unaware that trading out of a position could incur transaction costs as much as ten times higher than the recipient was expecting.

In addition, the "per 10 share" convention is inconsistent with the ODD. The ODD defines the term "unit of trading" as the "amount of the underlying interest that is subject to being purchased or sold upon the exercise of a single option contract."⁶ The ODD defines the "premium" as "the price that the holder of an option pays and the writer of an option receives for the rights conveyed by the option."⁷ The ODD describes the "aggregate premium" for an option contract as being determined by multiplying the premium for the contract times the unit of trading for the contract.⁸ The aggregate premium for a jumbo ETF would not be calculated in the way described in the ODD. Instead, it would be calculated by multiplying the premium for the option based on the "virtual" security (i.e., ten times the actual premium for the contract) times the unit of trading for the option based on the "virtual" security (i.e., one-tenth the actual unit of

⁵ The NYSE Amex proposal fails to identify the specific underlying of Jumbo Options (e.g., ten ETF shares, ten times the ETF value) and it is not clear whether the underlying is a construct or a new security. If the filing results in the creation of a new security, presumably that security would be subject to the registration requirements of the Securities Act of 1933. If the filing results in the creation of a construct – 10 times ETF value – there is no market in such a construct and there is only a market in the ETF. NYSE Amex's proposed rule text avoids identifying the underlying for a Jumbo Option and is therefore, also incomplete.

⁶ See page 8 of the ODD.

⁷ See page 11 of the ODD.

⁸ See page 8 of the ODD.

trading for the contract). In effect, the premiums would be quoted for an option based on a security that does not exist.

Similarly, the ODD defines the term "exercise price" as "the price at which the option holder has the right either to purchase or to sell the underlying interest," and provides the following example: "A physical delivery XYZ 40 call option gives the option holder the right to purchase 100 shares of XYZ stock at an exercise price of \$40 a share."⁹ For Jumbo ETFs, the parallel to that example under the ODD's disclosure would be that a "Jumbo ETF XYZ 40 call option would give the option holder the right to purchase 1,000 shares of the XYZ ETF at an exercise price of \$40 a share." Instead, because the exercise right would be changed under the NYSE Amex proposal, the proper description would need to be that a "Jumbo ETF XYZ 400 call option would give the option holder the right to purchase one-tenth of 1,000 shares of the XYZ ETF" – a scenario that is different than what ODD describes.

A reader of the relevant passages in the ODD would come to an incorrect conclusion as to what to expect from these products. For example, a seller of a Jumbo Option who knows that the unit of trading is equal to 1,000 shares would expect, based on the ODD, to receive the quoted "per ten share" premium times 1,000 – ten times more than in fact the seller would receive. CBOE believes that changing established industry convention in setting strike prices and quoting conventions for these products is likely to result in more, not less, confusion and would be inconsistent with the ODD.

Furthermore, although NYSE Amex in proposing to amend only its own rules, if its rule amendments become effective they will establish the pattern for the way that these products are quoted, and exercise prices for them are established, for all of the options exchanges that decide to list these products. To put this another way, if the NYSE Amex proposed rule changes become effective, it will be impossible for another exchange to provide a market for the trading of the same (fungible) Jumbo options with their exercise prices and quotations stated in the more "traditional" (and, CBOE believes, correct) form.

II. Proposal to Eliminate Position and Exercise Limits for All Options on DIA, SPY, IWM and QQQQ

The first part of the NYSE Amex proposal is to eliminate position and exercise limits for all options on DIA, SPY, IWM and QQQQ. In support of this proposal, NYSE Amex argues, among other reasons, that: (1) there are no position limits for certain cash settled index options because those indexes are "comprised of many equities further mitigating concerns about manipulation..." and (2) "ETFs are structured as open-ended trusts or mutual funds that can continually issue new shares as required to satisfy demand." Unlike cash-settled options, this argument ignores the fact that there is a practical limitation to the number of shares any fund may issue. Specifically, the four ETFs at issue cannot grow beyond the number of existing shares of the constituent

⁹ See page 11 of the ODD.

securities of the indexes whose performance they track. More importantly, the issuance of new shares of an ETF is dependent upon deposit of shares underlying the ETF in size sufficient to satisfy the "creation unit" criteria of an ETF issuance. If a market participant desiring to create new ETF shares does not have the underlying shares in sufficient size, the market participant will have to go into the open market to obtain the shares for delivery. Thus, it is entirely possible that the elimination of position and exercise limits for these ETF options could cause a disruption in the marketplace if an inordinately large increase in an underlying ETF position necessitated large open market purchases of the shares comprising the ETF. A measured approach to setting position and exercise limits should continue to be applied so as not to create a framework where market disruption problems may develop.

Finally, NYSE Amex's request to eliminate positions and exercise limits for options on DIA, SPY, IWM and QQQQ is inconsistent with the SEC's historical approach to position limit increases, including obtaining input from the SEC's Office of Economic Analysis. The SEC has consistently taken an incremental and studied approach toward expansion of position and exercise limits. It would be inconsistent with this approach to allow the proposed change from position and exercise limits ranging from 300,000 contracts to 900,000 contracts to an elimination of all limits for physically settled options. In fact, the SEC has consistently expressed the belief that position and exercise limits serve a fundamental purpose. Specifically, the Commission recently stated,

[R]ules regarding position and exercise limits are intended to prevent the establishment of options positions that can be used or might create incentive to manipulate or disrupt the underlying market so as to benefit of the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulation and for corners and squeezes on the underlying market.¹⁰

NYSE-Amex is seeking to go from position and exercise limits ranging from 300,000 contracts to 900,000 contracts to the elimination of all such limits for physically settled contracts. The purported rationale proffered by NYSE Amex for this substantial step, however, does not justify a deviation from the SEC's measured approach to position limit increases.

On a related point, the NYSE Amex proposal provides for a generic rule that ETF options for which position and exercise limits have been eliminated would also be eligible for Jumbo Options. Consistent with our earlier comments, each product that may be eligible for Jumbo Options (if they are approved by the SEC) should be evaluated on a case-by-case basis and not simply because position and exercise limits for those products have been eliminated.

¹⁰ See Securities Exchange Act Release No. 57352 (February 19, 2008), 73 FR 10076 (February 25, 2008) (SR-CBOE-2008-07).

CBOE appreciates the opportunity to provide these comments. As noted above, CBOE is deeply troubled by the prospect of unequal treatment by the SEC between prior CBOE filings and the instant NYSE Amex filing as well as the prospect for a significant market structure policy retreat with respect to price protection without a release seeking industry comment. In addition, the proposal also raises significant investor confusion issues and would mark a departure from the SEC's approach to position limits should the NYSE Amex filing be approved. We strongly believe that the tenets of Section 19b of the Exchange Act require the SEC to disapprove the filing. The NYSE Amex proposal does not provide enough information or detail to enable CBOE to fully respond or to understand the products being proposed. In the event NYSE Amex amends or resubmits its filing, CBOE and others should have the opportunity to provide comments. Should you require any further information, please do not hesitate to contact the undersigned.

Sincerely,

A handwritten signature in blue ink that reads "Edward J. Joyce" with a horizontal line extending to the right.

Edward J. Joyce

cc:

Elizabeth King
John Roeser
Joanne Moffic-Silver
Jenny Klebes