SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65116; File No. SR-CBOE-2011-055)

August 11, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting
Approval of Proposed Rule Change to Trade Options on the CBOE Silver ETF Volatility Index

I.   Introduction

On June 15, 2011, Chicago Board Options Exchange, Incorporated (the "Exchange" or

"CBOE") filed with the Securities and Exchange Commission (the "Commission"), pursuant to

Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] a proposed rule change to

trade options on the CBOE Silver ETF Volatility Index ("VXSLV"). The proposed rule change

was published for comment in the Federal Register on June 28, 2011.[2] The Commission

received no comment letters on the proposed rule change. This order approves the proposed rule

change.

II.   Description

The Exchange proposes to amend certain of its rules to allow the listing and trading of

cash-settled, European-style options on VXSLV.

The Exchange has previously received approval orders to trade options on other volatility

indexes that are calculated using certain individual stock and exchange-traded fund ("ETF")

options listed on CBOE.[3] In the most recent approval order, the Exchange genericized certain of

its rules to collectively refer to these indexes as "Individual Stock Based Volatility Indexes,"

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[1]   15 U.S.C. 78s(b)(1).

[2]   See Securities Exchange Act Release No. 64722 (June 22, 2011), 76 FR 37868.

[3]   See Securities Exchange Act Release Nos. 62139 (May 19, 2010), 75 FR 29597 (May 26,
        2010) (order approving proposal to list and trade CBOE Gold ETF Volatility Index
        ("GVZ") options on CBOE) and 64551 (May 26, 2011), 76 FR 32000 (June 2, 2011)
        (order approving proposal to list and trade options on certain individual stock based
        volatility indexes and ETF based volatility indexes).

"ETF Based Volatility Indexes," and "Volatility Indexes," as applicable.[4] The specific Individual Stock Based Volatility Indexes and ETF Based Volatility Indexes that have been approved for options trading are listed in Rule 24.1(bb). This filing layers VXSLV into CBOE's existing rule framework for "ETF Based Volatility Indexes" and "Volatility Indexes," since VXSLV is comprised of ETF options.

Index Design and Calculation

The calculation of VXSLV is based on the VIX methodology applied to options on the iShares Silver Trust ("SLV"). The VXSLV index was introduced by CBOE on March 16, 2011 and has been disseminated in real-time on every trading day since that time.[5]

VXSLV is an up-to-the-minute market estimate of the expected volatility of SLV calculated by using real-time bid/ask quotes of CBOE listed SLV options. VXSLV uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected (implied) volatility.

For each contract month, CBOE will determine the at-the-money strike price. The Exchange will then select the at-the-money and out-of-the money series with non-zero bid prices and determine the midpoint of the bid-ask quote for each of these series. The midpoint quote of each series is then weighted so that the further away that series is from the at-the-money strike, the less weight that is accorded to the quote. Then, to compute the index level, CBOE will calculate a volatility measure for the nearby options and then for the second nearby options. This is done using the weighted mid-point of the prevailing bid-ask quotes for all included option

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[4]   See Rules 12.3, 24.1(bb), 24.4C, 24.5.04, 24.6, 24.9, 24A.7, 24A.8, 24B.7 and 24B.8.

[5]   CBOE maintains a micro-site for VXSLV:
        http://www.cboe.com/micro/VIXETF/VXSLV/.

series with the same expiration date. These volatility measures are then interpolated to arrive at a single, constant 30-day measure of volatility.[6]

CBOE will compute values for VXSLV underlying option series on a real-time basis throughout each trading day, from 8:30 a.m. until 3:00 p.m. (Chicago time).[7] VXSLV levels will be calculated by CBOE and disseminated at 15-second intervals to major market data vendors.

Options Trading

VXSLV options will trade pursuant to the existing trading rules for other Volatility Index options. VXSLV options will be quoted in index points and fractions and one point will equal $100. The minimum tick size for series trading below $3 will be 0.05 ($5.00) and above $3 will be 0.10 ($10.00). Initially, the Exchange will list in-, at- and out-of-the-money strike prices and the procedures for adding additional series are provided in Rule 5.5.[8] Dollar strikes (or greater) will be permitted for VXSLV options where the strike price is $200 or less and $5 or greater strikes will be permitted where the strike price is greater than $200. The Exchange will not be permitted to list LEAPS on VXSLV options at strike price intervals less than $1.[9]

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[6]   See proposed amendment to Interpretation and Policy .01 to Rule 24.1 (designating CBOE as the reporting authority for VXSLV).

[7]   Trading in SLV options (the index components of VXSLV) on CBOE closes at 3:00 p.m. (Chicago time). See Rule 24.6.02. The Exchange proposes to make non-substantive changes to this rule.

[8]   See Rule 5.5(c). "Additional series of options of the same class may be opened for trading on the Exchange when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying…moves substantially from the initial exercise price or prices." For purposes of this rule, "market price" shall mean the implied forward level based on any corresponding futures price or the calculated forward value of VXSLV.

[9]   See Rule 24.9.01(l). The Exchange proposes to amend Rule 24.9.01(l) by expressly providing that "[t]he Exchange shall not list LEAPS on Volatility Index options at strike price intervals less than $1." The Exchange notes that when GVZ options were approved for trading, a substantially similar provision regarding the strike price intervals for LEAPS was adopted. See Securities Exchange Act Release No. 62139 (May 19, 2010)

Transactions in VXSLV may be effected on the Exchange between the hours of 8:30 a.m. (Chicago time) and 3:00 p.m. (Chicago time). The Exchange proposes to close trading at 3:00 p.m. (Chicago time) for VXSLV options because trading in SLV options on CBOE closes at 3:00 p.m. (Chicago time).[10]

Exercise and Settlement

The proposed options will typically expire on the Wednesday that is 30 days prior to the third Friday of the calendar month immediately following the expiration month (the expiration date of the options used in the calculation of the index). If the third Friday of the calendar month immediately following the expiring month is a CBOE holiday, the expiration date will be 30 days prior to the CBOE business day immediately preceding that Friday.[11] For example, November 2011 Vol VXSLV options would expire on Wednesday, November 16, 2011, exactly 30 days prior to the third Friday of the calendar month immediately following the expiring month.

Trading in the expiring contract month will normally cease at 3:00 pm (Chicago time) on the business day immediately preceding the expiration date. Exercise will result in delivery of cash on the business day following expiration. VXSLV options will be A.M.-settled.[12] The exercise settlement value will be determined by a Special Opening Quotations ("SOQ") of

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75 FR 29597 (May 26, 2010). However, when the Exchange filed to list options on certain individual stock based volatility indexes and ETF based volatility indexes, the Exchange revised the strike setting parameters for Volatility Index options to permit $1 strikes where the strike price is $200 or less. The LEAPS strike setting provision was inadvertently not carried forward at the time Rule 24.9.01(l) was adopted, but should have been.

[10]   See Rule 24.6.02.

[11]   See Rule 24.9(a)(5).

[12]   See proposed amendment to Rule 24.9(a)(4) (adding VXSLV to the list of A.M.-settled index options approved for trading on the Exchange).

VXSLV calculated from the sequence of opening prices of a single strip of options expiring 30 days after the settlement date. The opening price for any series in which there is no trade shall be the average of that options' bid price and ask price as determined at the opening of trading.[13]

The exercise-settlement amount will be equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by $100. When the last trading day is moved because of a CBOE holiday, the last trading day for expiring options will be the day immediately preceding the last regularly-scheduled trading day.

Position and Exercise Limits

The Exchange proposes that the existing position limits for ETF Based Volatility Index options apply to VXSLV options.[14] For regular options trading, the position limit for VXSLV options will be 50,000 contracts on either side of the market and no more than 30,000 contracts in the nearest expiration month. CBOE believes that a 50,000 contract position limit is appropriate due to the fact that SLV options, which are the underlying components for VXSLV, are among the most actively traded option classes currently listed. In determining compliance with these proposed position limits, VXSLV options will not be aggregated with the SLV options.[15] Positions in Short Term Options Series, Quarterly Options Series, and Delayed Start Options Series will be aggregated with position in options contracts in the same VXSLV class.[16]

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[13]   See Rule 24.9(a)(5).

[14]   See Rule 24.4C (Position Limits for Individual Stock or ETF Based Volatility Index Options).

[15]   See Rule 24.4C(b).

[16]   See proposed new subparagraph (c) to Rule 24.4C. The Exchange proposes to add new subparagraph (c) regarding aggregation to Rule 24.4C. The Exchange notes that when GVZ options were approved for trading, the position limits for GVZ options were layered into existing Rule 24.4 (Position Limits for Broad-Based Index Options). Rule 24.4(e) sets forth an aggregation requirement substantially similar to proposed new subparagraph (c) to Rule 24.4C. See Securities Exchange Act Release No. 62139 (May 19, 2010), 75

Exercise limits will be equivalent to the proposed position limits.[17] VXSLV options will be

subject to the same reporting requirements triggered for other options dealt in on the Exchange.

The Exchange proposes that the existing position limits for FLEX ETF Based Volatility

Index options apply to VXSLV options. Specifically, the position limits for FLEX VXSLV

options will be equal to the position limits for Non-FLEX VXSLV options.[18] Similarly, the

exercise limits for FLEX VXSLV options will be equivalent to the position limits set forth in

Rule 24.4C. As provided for in Rules 24A.7(d) and 24B.7(d), as long as the options positions

remain open, positions in FLEX VXSLV options that expire on the same day as Non-FLEX

VXSLV Index options, as determined pursuant to Rule 24.9(a)(5), shall be aggregated with

positions in Non-FLEX VXSLV options and shall be subject to the position limits set forth in

Rules 4.11, 24.4, 24.4A, 24.4B and 24.4C, and the exercise limits set forth in Rules 4.12 and

24.5.

The Exchange proposes that the existing Hedge Exemption for ETF Based Volatility

Index options apply to VXSLV options, which would be in addition to the standard limit and

other exemptions available under Exchange rules, interpretations and policies. The following

procedures and criteria must be satisfied to qualify for an ETF Based Volatility Index hedge

exemption:

- The account in which the exempt option positions are held ("hedge exemption account")

  has received prior Exchange approval for the hedge exemption specifying the maximum

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FR 29597 (May 26, 2010). When the Exchange filed to list options on certain individual stock based volatility indexes and ETF based volatility indexes, the Exchange removed GVZ from Rule 24.4 and proposed a new rule setting forth positions limits for these products. The aggregation requirement from Rule 24.4(e) was inadvertently not carried forward at the time Rule 24.4C was adopted, but should have been.

[17] See Rule 24.5.

[18] See Rules 24A.7(a)(5) and 24B.7(a)(5).

number of contracts which may be exempt. The hedge exemption account has provided all information required on Exchange-approved forms and has kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two (2) business days or such other time period designated by the Department of Market Regulation furnish the Department of Market Regulation with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

- A hedge exemption account that is not carried by a CBOE member organization must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.

- The hedge exemption account maintains a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of a net long or short position in ETF Based Volatility Index futures contracts or in options on ETF Based Volatility Index futures contracts, or long or short positions in ETF Based Volatility Index options, for which the underlying ETF Based Volatility Index is included in the same margin or cross-margin product group cleared at the Clearing Corporation as the ETF Based Volatility Index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.

- The exemption applies to positions in ETF Based Volatility Index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The

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unhedged value will be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the standard limit, the underlying market value (a) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (b) of any opposite side of the market positions in ETF Based Volatility Index futures, options on ETF Based Volatility Index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows—the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

- Only the following qualified hedging transactions and positions will be eligible for purposes of hedging a qualified portfolio (i.e., futures and options) pursuant to Interpretation .01 to Rule 24.4C:

    o Long put(s) used to hedge the holdings of a qualified portfolio;

    o Long call(s) used to hedge a short position in a qualified portfolio;

    o Short call(s) used to hedge the holdings of a qualified portfolio; and

    o Short put(s) used to hedge a short position in a qualified portfolio.

- The following strategies may be effected only in conjunction with a qualified stock portfolio:

    o A short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (a "collar"). Neither side of the collar transaction

can be in-the-money at the time the position is established. For purposes of
determining compliance with Rule 4.11 and Rule 24.4C, a collar position will be
treated as one (1) contract;

- o A long put position coupled with a short put position overlying the same ETF
  Based Volatility Index and having an equivalent underlying aggregate index
  value, where the short put(s) expires with the long put(s), and the strike price of
  the long put(s) exceeds the strike price of the short put(s) (a "debit put spread
  position"); and

- o A short call position accompanied by a debit put spread position, where the short
  call(s) expires with the put(s) and the strike price of the short call(s) equals or
  exceeds the strike price of the long put(s). Neither side of the short call, long put
  transaction can be in-the-money at the time the position is established. For
  purposes of determining compliance with Rule 4.11 and Rule 24.4C, the short call
  and long put positions will be treated as one (1) contract.

- The hedge exemption account shall:
  - o liquidate and establish options, their equivalent or other qualified portfolio
    products in an orderly fashion; not initiate or liquidate positions in a manner
    calculated to cause unreasonable price fluctuations or unwarranted price changes.

  - o liquidate any options prior to or contemporaneously with a decrease in the hedged
    value of the qualified portfolio which options would thereby be rendered
    excessive.

  - o promptly notify the Exchange of any material change in the qualified portfolio
    which materially affects the unhedged value of the qualified portfolio.

- If an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted.

Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX, XXIV, XXIVA, and XXIVB will equally apply to VXSLV options.

The Exchange proposes that the margin requirements for VXSLV options be set at the same levels that apply to ETF Based Volatility Index options under Exchange Rule 12.3. Margin of up to 100% of the current market value of the option, plus 20% of the underlying volatility index value must be deposited and maintained. Additional margin may be required pursuant to Exchange Rule 12.10.

As with other ETF Based Volatility Index options, the Exchange designates VXSLV options as eligible for trading as Flexible Exchange Options as provided for in Chapters XXIVA (Flexible Exchange Options) and XXIVB (FLEX Hybrid Trading System). The Exchange notes that FLEX VXSLV options will only expire on business days that non-FLEX VXSLV options expire. This is because the term "exercise settlement value" in Rules 24A.4(b)(3) and 24B.4(b)(3), *Special Terms for FLEX Index Options*, has the same meaning set forth in Rule 24.9(a)(5). As is described earlier, Rule 24.9(a)(5) provides that the exercise settlement value of VXSLV options for all purposes under CBOE Rules will be calculated as the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which a VXSLV option expires.

Capacity

CBOE has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority have the necessary systems capacity to handle the additional

traffic associated with the listing of new series that would result from the introduction of

VXSLV options.

Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the

Exchange's other Volatility Index and index options to monitor trading in VXSLV options. The

Exchange further represents that these surveillance procedures shall be adequate to monitor

trading in VXSLV options. For surveillance purposes, the Exchange will have complete access

to information regarding trading activity in the pertinent underlying securities.

III.   Discussion

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.[19]

Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the

Act,[20] 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.

The Commission notes that it has previously approved the listing and trading of options

on volatility indexes that are calculated using certain individual stock and ETF options listed on

CBOE, and CBOE has genericized certain of its rules to collectively refer to these indexes as

"Individual Stock Based Volatility Indexes," "ETF Volatility Based Indexes," and "Volatility

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[19]   In approving this proposed rule change, the Commission has considered the proposed
        rule's impact on efficiency, competition, and capital formation.

[20]   15 U.S.C. 78f(b)(5).

Indexes."[21] The Commission notes that this filing layers VXSLV into CBOE's existing framework for "ETF Volatility Based Indexes" and "Volatility Indexes," since VXSLV is comprised of ETF options.

As a national securities exchange, CBOE is required under Section 6(b)(1) of the Act[22] to enforce compliance by its members, and persons associated with its members, with the provisions of the Act, Commission rules and regulations thereunder, and its own rules. In addition, brokers that trade VXSLV options will also be subject to best execution obligations and FINRA rules.[23] Applicable Exchange rules also require that customers receive appropriate disclosure before trading VXSLV options.[24] Furthermore, brokers opening accounts and recommending options transactions must comply with relevant customer suitability standards.[25]

VXSLV options will trade pursuant to the existing rules for other Volatility Index options. The Commission believes that the listing rules proposed by CBOE for VXSLV options are consistent with the Act. Dollar or greater strikes for VXSLV options where the strike price is $200 or less and $5 or greater strikes when the strike price is greater than $200 should provide investors with greater flexibility in the trading of VXSLV options and further the public interest by allowing investors to establish positions that are better tailored to meet their investment objectives.

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[21]   See supra note 3.

[22]   15 U.S.C. 78f(b)(1).

[23]   See NASD Rule 2320.

[24]   See CBOE Rule 9.15.

[25]   See FINRA Rule 2360(b) and CBOE Rules 9.7 and 9.9.

The Commission notes that CBOE will compute values for VXSLV underlying option series on a real-time basis throughout each trading day, and that VXSLV levels will be calculated by CBOE and disseminated at 15-second intervals to major market data vendors.

The Commission believes that the Exchange's proposed position limits and exercise limits for VXSLV options are appropriate and consistent with the Act. The Commission notes that the Exchange proposed that the existing position limits for ETF Based Volatility Index options will apply to VXSLV options. The Commission also notes the Exchange stated that SLV options, which are the underlying components for VXSLV, are among the most actively traded option classes currently listed. In addition, the Commission notes that the existing position limits for FLEX ETF Based Volatility Index options will apply to VXSLV options, and the position and exercise limits for FLEX VXSLV options will be equal to the position and exercise limits for Non-FLEX VXSLV options. Further, positions in FLEX VXSLV options that expire on the same day as Non-FLEX VXSLV options will be aggregated with positions in Non-FLEX VXSLV options.

The Commission also notes that the margin requirements for ETF Based Volatility Index options will apply to options on VXSLV. The Commission finds this to be reasonable and consistent with the Act.

Further, the Commission believes that the Exchange's proposal to allow VXSLV options to be eligible for trading as FLEX options is consistent with the Act. The Commission previously approved rules relating to the listing and trading of FLEX options on CBOE, which give investors and other market participants the ability to individually tailor, within specified limits, certain terms of those options.[26] The Commission has also previously approved the listing

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[26] See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993).

and trading of FLEX options on ETF Based Volatility Indexes. The current proposal

incorporates VXSLV options that trade as FLEX options into these existing rules and regulatory

framework.

The Commission notes that CBOE represented that it has an adequate surveillance

program to monitor trading of VXSLV options and intends to apply its existing surveillance

program to support the trading of these options. Finally, in approving the proposed rule change,

the Commission has relied upon the Exchange's representation that it has the necessary systems

capacity to support new options series that will result from this proposal.

IV.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[27] that the

proposed rule change (SR-CBOE-2011-055) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated

authority.[28]

Elizabeth M. Murphy
Secretary

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[27]   15 U.S.C. 78s(b)(2).

[28]   17 CFR 200.30-3(a)(12).