

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74914; File No. SR-CBOE-2015-044)

May 8, 2015

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule to Introduce Asian style Settlement and Cliquet Style Settlement for FLEXible Exchange Broad-Based Index Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 6, 2015, the Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II 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

Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) proposes to introduce Asian style settlement and Cliquet style settlement for FLEXible Exchange (“FLEX”) Broad-Based Index options. The proposed rule change would not amend the text of Rule 12.4 (Portfolio Margin); however, the Exchange believes that it would be appropriate to include the proposed options in portfolio margining. The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, and at the Commission.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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 self-regulatory organization 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 parts of such statements.

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

1. Purpose

The purpose of this proposed rule change is to permit the Exchange to introduce Asian style settlement and Cliquet style settlement for FLEXible Exchange (“FLEX”) Broad-Based Index options. In general, Asian style settlement provides for payout based on the average of prices of a broad-based index on pre-determined dates over a specified time period and Cliquet style settlement provides for a payout that is the greater of \$0 or the (positive) sum of “capped” monthly returns of a broad-based index on pre-determined dates over a specified period of time.

FLEX Broad-Based Index options provide users with the ability to customize key contract terms, like exercise prices, exercise styles, expiration dates and exercise settlement values. After surveying potential FLEX Broad-Based index options users, the Exchange learned that indexed annuity writers (insurance companies) extensively use over-the-counter (“OTC”) options with Asian and Cliquet style settlement as a crediting method.<sup>3</sup> Because of the level of customization that FLEX Broad-Based Index options provide, the Exchange seeks to introduce exchange-traded products that would provide potential market users with an alternative to the

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<sup>3</sup> A “crediting method” is the method used to measure the change in the underlying index (e.g., point-to-point or annual reset).

OTC market in customized options.

### Index Annuity Writer Use of Asian and Cliquet Options

For background, an indexed annuity is an insurance contract that is typically tied to a financial market index, e.g., S&P 500 Index, and the return is guaranteed not to fall below a level specified in the contract. Indexed annuity contracts typically provide that the contract holder will be credited interest according to a specified formula based on changes to the index to which the annuity contract is linked. Indexed annuity contracts often have exotic option liabilities embedded within those contracts.

One type of annuity contract is an Asian contract (sometimes referred to as an averaging contract) because the settlement value is based on an average of selected closing prices of an index over a year. The contract holder of this type of contract is typically entitled to receive a credit on the anniversary date in an amount equal to the greater of \$0 and the difference between the average price of an index and the level of the index from the date of inception or the previous anniversary date.

Another type of annuity contract is a Cliquet contract (sometimes referred to as a contract with a monthly return cap with a global floor) because its payoff is the greater of zero or the sum of monthly capped returns of an index over a year. The contract holder of this type of contract is typically entitled to receive a credit on the anniversary date in an amount based on the sum of monthly returns (subject to a monthly cap) if the sum of monthly returns is greater than 0. If the sum of the monthly capped returns is 0 or less, the holder would not realize a loss (other than the premium paid) because the sum of monthly capped returns has a global floor of 0.

Insurance companies that write indexed annuity contracts, therefore, seek financial tools to manage and hedge the embedded exotic option risk in these contracts. Historically, these

insurers have traded exclusively in the OTC market by entering into bilateral contracts tailored to the terms of indexed annuity contracts. CBOE proposes to introduce two new kinds of settlement styles for FLEX Broad-Based Index options that would provide insurers with alternative hedging tools to OTC products, coupled with traditional exchange-traded benefits like price discovery, transparency and centralized clearing.

#### Asian Style Settlement

FLEX Broad-Based Index options with Asian style settlement would be cash-settled call<sup>4</sup> option contracts for which the final payout would be based on an arithmetic average of specified closing values of the underlying broad-based index (“Asian option”). Exercise (strike) prices and premium quotations for Asian options would be expressed and governed as provided for in Rules 24A.4(b)(2) and 24B.(b)(2). Asian options would have a term of approximately one year and would expire anytime from 350 to 371 days (which is approximately 50 to 53 calendar weeks) from the date of initial listing. The contract multiplier for an Asian option would be \$100.<sup>5</sup>

The parties to an Asian option contract would designate a set of monthly observation dates and an expiration date for each contract. The monthly observation date would be the date each month on which the price of the underlying broad-based index would be observed for the purpose of calculating the exercise settlement value for Asian options. Each Asian option would have 12 consecutive monthly observation dates (which includes an observation on the expiration date) and each observation would be based on the closing price of the underlying broad-based index. The specific monthly observation dates would be determined by working backward from

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<sup>4</sup> Puts would not be permitted.

<sup>5</sup> See Rules 24A.1(i) and 24B.1(m). “The Index Multiplier for FLEX Index Options is \$100.”

the farthest out observation date prior to the expiration date. If a given monthly observation date falls on a non CBOE business day (e.g., holiday or weekend), the monthly observation would be on the immediately preceding business day (“preceding business day convention”). The parties may not designate a subsequent business day convention for Asian options.

Asian options would have European-style exercise and may not be exercised prior to the expiration date. The exercise settlement value for Asian options would be the arithmetic average of the closing values of the underlying broad-based index on the 12 consecutive monthly observation dates, which include the expiration date of the option. Mathematically this is expressed as:

$$\text{Exercise Settlement Value} = \frac{\sum_{i=1}^{12} S_i}{12}$$

Where  $S_i$  is the closing price of the underlying broad-based index on monthly observation date on the  $i^{\text{th}}$  monthly observation date.

The exercise settlement amount for Asian options would be calculated similarly to other options, i.e., the difference between the strike price and the averaged settlement value would determine the value, or “moneyness” of the contract at expiration.

An example of an Asian FLEX call option expiring in-the-money follows. On January 21, 2015, an investor hedging the value of the S&P 500 Index over a year purchases a call option expiring on January 22, 2016 with a strike price of 2000 and a contract multiplier of \$100. The option has monthly observation dates occurring on the 23<sup>rd</sup> of each month.

Monthly Observation Date	S&P 500 Index Closing Value
23-Feb-15	2025.36
23-Mar-15	2049.34
23-Apr-15	2019.77
<b>22-May-15*</b>	1989.65

Monthly Observation Date	S&P 500 Index Closing Value
23-Jun-15	2005.64
23-Jul-15	2035.10
<b>21-Aug-15*</b>	2032.15
23-Sep-15	2076.18
23-Oct-15	2099.01
23-Nov-15	2109.32
23-Dec-15	2085.42
22-Jan-16	<u>2084.81</u>
Exercise (Averaged) Settlement Value	24,611.75/12 = <b>2050.98</b>

\* Because Asian FLEX options use the “preceding business day convention,” the dates of May 23, 2015 and August 23, 2015, were not used in the above example because those dates will fall on a weekend or a holiday. Instead the business days immediately preceding those dates were used as the monthly observation date.

The exercise settlement amount for this 2000 Asian FLEX call option would be equal to \$5,098. This amount would be determined by adding the 12 observed closing values for the S&P 500 Index and dividing that amount by 12 (24,611.75/12), which is equal to 2050.98 (when rounded). As a result, this 2000 call option would be \$5,098 in-the-money (50.98 x \$100).

If, in the above example, the strike price for the Asian FLEX call option was 2060, that contract would have expired out-of-the-money. This is because the exercise settlement value for this 2060 call option is equal to 2050.98 (when rounded). Since the strike price of 2060 is more than the 2050.98 exercise settlement value, this option would not be exercised and would expire worthless.

#### Cliquet Style Settlement

FLEX Broad-Based Index options with Cliquet style settlement would be cash-settled call<sup>6</sup> option contracts for which the final payout would be based on the sum of monthly returns (i.e., percent changes in the closing value of the underlying broad-based index from one monthly observation date to the next monthly observation date), subject to a monthly return “cap” (e.g.,

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<sup>6</sup> Puts would not be permitted.

2%) applied over 12 monthly observation dates (“Cliquet option”). Premium quotations for Cliquet options would be expressed and governed as provided for in Rules 24A.4(b)(2) and 24B.(b)(2). Cliquet options would have a term of approximately one year and would expire anytime from 350 to 371 days (which is approximately 50 to 53 calendar weeks) from the date of initial listing. The contract multiplier for a Cliquet option would be \$100.<sup>7</sup>

The parties to a Cliquet option would designate a set of monthly observation dates for each contract and an expiration date for each contract. The monthly observation date would be the date each month on which the price of the underlying broad-based index would be observed for the purpose of calculating the exercise settlement value for Cliquet FLEX options. Each Cliquet FLEX option would have 12 consecutive monthly observation dates (which includes an observation on the expiration date) and each observation would be based on the closing price of the underlying broad-based index. The specific monthly observation dates would be determined working backward from the farther out observation date prior to the expiration date. If a given monthly observation date fell on a non CBOE business day (e.g., holiday or weekend), the monthly observation would be on the immediately preceding business day (“preceding business day convention”). The parties may not designate a subsequent business day convention for Cliquet options.

The parties to a Cliquet option would designate a capped monthly return (percent change in the closing values of the underlying broad-based index from one month to the next month) for the contract, which would be the maximum monthly return that would be included in the calculation of the exercise settlement value for the contract. On each monthly observation date, the Exchange would determine the actual monthly return (the percent change of the underlying

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<sup>7</sup> See Rules 24A.1(i) and 24B.1(m). “The Index Multiplier for FLEX Index Options is \$100.”

broad-based index) using the closing value of the broad-based index on the current monthly observation date and the closing value of the broad-based index on the previous monthly observation date. The Exchange would then compare the actual monthly return to the capped monthly return. The value to be included as the monthly return for a Cliquet option would be the lesser of the actual monthly return or the capped monthly return.

For example, if the actual monthly return of the underlying broad-based index was 1.75% and the designated capped monthly return for a Cliquet option was 2%, the 1.75% value would be included (and not the 2%) as the value for the observation date to determine the exercise settlement value. Using this same example, if the actual monthly return of the underlying broad-based index was 3.30%, the 2% value would be included (and not the 3.30%) as the value of the observation date to determine the exercise settlement value. This latter example illustrates that, Cliquet options have a capped upside. Cliquet options do not, however, have a capped downside for the monthly return that would be included in determining the exercise settlement value. Drawing on this same example, if the actual monthly return of the underlying broad-based index was -4.07%, the -4.07% value would be included as the value for the observation date to determine the exercise settlement value. There would be, however, be a global floor for Cliquet options so that if the sum of the monthly returns is negative, a Cliquet option would expire worthless.

Unlike other options, Cliquet options would not have a traditional exercise (strike) price. Rather, the exercise (strike) price field for a Cliquet option would represent the designated capped monthly return for the contract and would be expressed in dollars and cents. For example, a capped monthly return of 2.25% would be represented by the dollar amount of \$2.25. The “strike” price for a Cliquet option may only be expressed in a dollar and cents amount and



the “strike” price for a Cliquet option may only span a range between \$0.05 and \$25.95. In addition, the “strike” price for a Cliquet option may only be designated in \$0.05 increments, e.g., \$1.75, \$2.50, \$4.15. Increments of \$0.01 in the “strike” price field (representing the capped monthly return) would not be permitted.

The first “monthly” return for a Cliquet option would be based on the initial reference value, which would be the closing value of the underlying broad-based index on the date a new Cliquet option is listed. The time period measured for the first “monthly” return would be between the initial listing date and the first monthly observation date. For example, if a Cliquet option was opened on January 1 and the parties designated the 31<sup>st</sup> of each month as the monthly observation date, the measurement period for the first monthly return would span the time period from January 1 to January 31. The time period measured for the second monthly return, and all subsequent monthly returns, would run from the 31<sup>st</sup> of one month to the 31<sup>st</sup> of the next month (or the last CBOE business day of each month depending on the actual number of calendar days in each month covered by the contract).

Cliquet options would have European-style exercise and may not be exercised prior to the expiration date. The exercise settlement value for Cliquet options would be equal to the initial reference price of the underlying broad-based index multiplied by the sum of the monthly returns (with the cap applied) on the 12 consecutive monthly observation dates, which include the expiration date of the option, provided that the sum is greater than 0. If the sum of the monthly returns (with the applied cap) is 0 or a less, the option would expire worthless.<sup>8</sup> Mathematically this is expressed as:

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<sup>8</sup> Prior to expiration, it is possible that the accumulated monthly returns could become negative to a point at which it is known that the value of the contract at expiration would be zero. The holder or writer of such a position may choose to exit the position prior to expiration for a negligible credit or debit amount, respectively.

1.  $S_0 \times (1 + \sum_{i=1}^{12} CMR_i)$ ; and
2.  $S_0$

Where:  $S_0$  = Initial Reference Price

$CMR_i$  = MIN (Actual Monthly Return<sub>i</sub>, Capped Monthly Return)

$$Monthly\ Return_i = \frac{(S_i - S_{i-1})}{S_{i-1}}$$

$S_i$  = Closing Price of the Underlying Broad-Based Index on Monthly Observation

Date ( $i$ ).

An example of a Cliquet option follows. On January 21, 2015, an investor hedging the value of the S&P 500 Index over a year purchases a Cliquet FLEX call option expiring on January 22, 2016 with a capped monthly return of 2% and a contract multiplier of \$100. The initial reference price of the S&P 500 Index (closing value) on January 21, 2015 is 2000. The option has monthly observation dates occurring on the 23<sup>rd</sup> of each month.

Monthly Observation Date	S&P 500 Index Closing Value ( $S_i$ )	Actual Monthly Return	Capped Monthly Return ( $CMR_i$ )	Sum of Monthly Returns
23-Feb-15	2025.36	1.27%	1.27%	1.27%
23-Mar-15	2049.34	1.18%	1.18%	2.45%
23-Apr-15	2019.77	-1.44%	-1.44%	1.01%
<b>22-May-15*</b>	1989.65	-1.49%	-1.49%	-0.48%
23-Jun-15	2005.64	0.80%	0.80%	0.32%
23-Jul-15	2035.10	1.47%	1.47%	1.79%
<b>21-Aug-15*</b>	2032.15	-0.14%	-0.14%	1.65%
23-Sep-15	2076.18	2.17%	<b>2.00%**</b>	3.65%
23-Oct-15	2099.01	1.10%	1.10%	4.75%
23-Nov-15	2109.32	0.49%	0.49%	5.24%

Monthly Observation Date	S&P 500 Index Closing Value ( $S_i$ )	Actual Monthly Return	Capped Monthly Return ( $CMR_i$ )	Sum of Monthly Returns
23-Dec-15	2085.42	-1.13%	-1.13%	4.11%
22-Jan-16	2084.81	-0.03%	-0.03%	<b>4.08%</b>
Exercise Settlement Value	<b><math>[(4.08\% * 2000.00)] + 2 = 83.60</math></b>			

\* Because Cliquet FLEX options use the “preceding business day convention,” the dates of May 23, 2015, and August 23, 2015, were not used in the above example because those dates will fall on a weekend or a holiday. Instead the business days immediately preceding those dates were used as the monthly observation dates.

\* \*Monthly capped return applied.

The exercise settlement amount for this January 22, 2016 Cliquet option, with a capped monthly 2% return (“strike price”) and a contract multiplier of \$100 would be equal to \$8,360. This value would be calculated by summing the monthly capped returns (equal to 4.08%) and multiplying that amount by the initial reference price (equal to 2000), which equals 81.60. The “strike price” (2%) amount would then be added to that amount (81.60) to arrive at an exercise settlement value of 83.60. Because the “strike price” field for a Cliquet option would be the manner in which the designated capped monthly return would be identified for the contract and because the designated monthly return for the contract would have been already substantively applied to determine the exercise settlement value, the “strike price” of 2.0 would be subtracted from the exercise settlement value before the contract multiplier (\$100) would be applied  $[(83.60 - 2) * 100]$ . Accordingly, resulting payout for this contract would be \$8,160.

If the sum of the monthly capped returns had been negative, this option would have expired worthless.

#### Specific Rule Text Changes

To expressly permit Asian style settlement and Cliquet style settlement for FLEX Broad-Based Index options, CBOE is proposing to amend Rules 24A.1 (Definitions), 24A.4 (Terms of

FLEX Options), 24B.1 (Definitions) and 24B.4 (Terms of FLEX Options).<sup>9</sup> First, CBOE proposes to amend Rules 24A.1<sup>10</sup> and 24B.1<sup>11</sup> by adding the below definitions to those rules:

The term “Asian style settlement” is a settlement style that may be designated for FLEX Broad-Based Index Options and results in the contract settling to an exercise settlement value that is based on an arithmetic average of the specified closing prices of an underlying broad-based index taken on 12 predetermined monthly observation dates (including on the expiration date). FLEX Broad-Based Index Options with Asian style settlement have “preceding business day convention,” meaning that if a monthly observation date falls on a non CBOE business day (e.g., holiday or weekend), the monthly observation would be on the immediately preceding business day. FLEX Broad-Based Index Options with Asian style settlement have European-style exercise.

The term “Cliquet style settlement” is a settlement style that may be designated for FLEX Broad-Based Index Options and results in the contract settling to an exercise settlement value that is equal to the greater of \$0 or the sum of capped monthly returns (i.e., percent changes in the closing value of the underlying broad-based index from one month to the next month) applied over 12 predetermined monthly observation dates (including on the expiration date). FLEX Broad-Based Index Options with Cliquet style settlement have “preceding business day convention,” meaning that if a monthly observation date falls on a non CBOE business day (e.g., holiday or weekend), the monthly observation would be on the immediately preceding business day. FLEX Broad-Based Index Options with Cliquet style settlement have European-style exercise.

Second, the CBOE proposes to amend Rules 24A.4(b)<sup>12</sup> and 24B.4(b)<sup>13</sup> by adding the below terms that the parties to Asian options and Cliquet options must designate and the parameters governing the parties’ designations:

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<sup>9</sup> Chapter XXIVA sets forth Flexible Exchange Options rules and Chapter XXIVB sets forth FLEX Hybrid Trading System rules.

<sup>10</sup> The Exchange proposes to add the definitions of “Asian style settlement” and “Cliquet style settlement” to Rule 24A.1 as new subparagraphs (r) and (s), respectively.

<sup>11</sup> The Exchange proposes to add the definitions of “Asian style settlement” and “Cliquet style settlement” to Rule 24B.1 as new subparagraphs (aa) and (bb), respectively.

<sup>12</sup> The Exchange proposes to set forth the terms for Asian options and Cliquet options to Rule 24A.4(b) as new subparagraphs (5) and (6), respectively.

<sup>13</sup> The Exchange proposes to set forth the terms for Asian options and Cliquet options to Rule 24B.4(b) as new subparagraphs (5) and (6), respectively.

Asian style settlement. The parties to FLEX Broad-Based Index Options may designate Asian style settlement. FLEX Broad-Based Index Options with Asian style settlement shall be call options (no puts) and designated by: (i) the duration of the contract which may range from 350 to 371 days (which is approximately 50 to 53 calendar weeks) from the date of listing; (ii) the strike price; (iii) the expiration date which must be a CBOE business day; and (iv) a set of monthly observation dates.

Cliquet style settlement. The parties to FLEX Broad-Based Index Options may designate Cliquet style settlement. FLEX Broad-Based Index Options with Cliquet style settlement shall be call options (no puts) and be designated by: (i) the duration of the contract which may range from 350 to 371 days (which is approximately 50 to 53 calendar weeks) from the date of listing; (ii) the capped monthly return that must be expressed in dollars and cents and in increments not less than \$0.05 and must be a value between \$0.05 and \$25.95; (iii) the expiration date which must be a CBOE business day; and (iv) a set of monthly observation dates. The capped monthly return will serve as the “exercise (strike) price” for a FLEX Broad-Based Index Option with Cliquet style settlement.

Exhibit 3 presents contract specifications for Asian style settlement and Cliquet style settlement for FLEX Broad-Based Index options.

In CBOE’s experience, successful and popular products have often originated in the OTC marketplace. When such products lend themselves to more standardized terms, there is a natural migration to exchange trading which benefits the users of exchange listed products. CBOE believes that market participants can 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 Broad-Based Index options.<sup>14</sup>

CBOE believes that expressly permitting Asian and Cliquet FLEX Broad-Based Index

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<sup>14</sup> The launch of Asian and Cliquet options would be permitted subject to the Commission’s approval of an OCC rule filing to make risk model changes necessary to accommodate the clearance and settlement of the proposed options. The Exchange would issue a circular to Trading Permit Holders to announce a specific launch date for the proposed options.

options is important and necessary to the Exchange's efforts to create a market that provides individuals interested in FLEX-type options with an improved but comparable alternative to the OTC market in customized options, which can take on contract characteristics similar to FLEX Options but are not subject to the same restrictions. By making these changes, market participants would now have greater flexibility in determining whether to execute their customized options in an exchange environment or in the OTC market.

### Margin

CBOE proposes a strategy-based margin requirement in Rule 12.3 (Margin Requirements) for short Asian options that would incrementally decrease over time. Settlement of Asian options would be based on the arithmetic average of closing values (on specified observation dates) of the underlying broad-based index. Volatility would be generally lowered due to the averaging effect. A cumulative average develops as observation dates pass, and subsequent observation date broad-based index values have gradually less influence on the average. Because of the averaging effect, CBOE believes that a margin requirement that incrementally decreases over time is warranted.

For an Asian option having an underlying index that is broad-based, CBOE proposes that the same margin requirement currently applicable to a standard broad-based index call option be applied to an Asian option during the first quartile of its life, which ends with the third observation date. The current initial and maintenance margin requirement for a standard broad-based index call option carried short is the option premium received (or current market value), plus 15% of the underlying broad-based index value less any out-of-the-money amount, to a minimum of the option premium received (or current market value), plus 10% of the underlying broad-based index value. CBOE proposes to decrease the 15% basic and 10% minimum to 8% and 6%, respectively, after the third observation date; to 6% and 4% after the sixth observation

date; and lastly, to 5% and 3% after the ninth observation date.

CBOE believes it is appropriate to include Asian options in portfolio margining.<sup>15</sup>

CBOE proposes a strategy-based margin requirement in Rule 12.3 for short Cliquet options that, with one exception, would also incrementally decrease over time. Settlement of Cliquet options would be based on the sum of the returns for 12 consecutive time periods of approximately 30 days in length, each ending on an observation date. In the case of Cliquet options with capped monthly returns, volatility would be generally lowered because of the capping effect. In addition, the lower the capped monthly return, the lower the sensitivity to moves in the underlying broad-based index.

Also, the sum of returns for 12 consecutive time periods, based on historical analysis, is expected to be less than the return on the underlying broad-based index from beginning to end of the same 12 consecutive month time period, except in the case of a negative return. However, with a Cliquet option, a negative sum of returns would be excluded as a possibility because a floor of zero would be set for the sum of returns. Additionally, a cumulative return develops as observation dates pass, and as subsequent observation date returns compile, the likelihood of the sum of returns increasing or decreasing significantly would gradually be lowered. Because of these influences, CBOE believes that a margin requirement that incrementally decreases over time is warranted.

Because Cliquet options would not have a traditional exercise (strike) price, no out-of-the-money amount deduction would be calculated for margin purposes. Therefore, no minimum percentage margin requirement would be necessary in that, without an out-of-the-money

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<sup>15</sup> A theoretical pricing model would continue to be used to derive position values at each valuation point for the purpose of determining the gain or loss. Currently the only model that qualifies is OCC's Theoretical Intermarket Margining System ("TIMS").

calculation, the margin requirement calculated using the basic margin requirement percentage would never be reduced.

For Cliquet options, three separate categories, based on a time frame within the life of a Cliquet option, would be established for margin requirement purposes. The three categories proposed are: 1) the time period starting with the trade through the 10<sup>th</sup> observation date; 2) the time period starting after the 10<sup>th</sup> observation date through the 11<sup>th</sup> observation date; and 3) the time period starting after the 11<sup>th</sup> observation date through the 12<sup>th</sup> (final) observation date.

During the time period starting with a Cliquet option's trade date through its 10<sup>th</sup> observation date, in the case of an index that is broad-based, CBOE proposes a margin requirement of 100% of the current market value of the option plus the percentage of the current "underlying component value." The percentage required would be the lesser of: the cap percentage multiplied by three (3) or 15%.<sup>16</sup>

CBOE proposes to decrease the percentage requirement to the lesser of: the cap percentage multiplied by two (2) or 15% beginning after the 10<sup>th</sup> observation date through the 11<sup>th</sup> observation date, and to further decrease the percentage requirement to the lesser of: the cap percentage or 15% beginning after the 11<sup>th</sup> observation date through the 12<sup>th</sup> (final) observation date.

CBOE believes it is appropriate to include Cliquet options in portfolio margining.<sup>17</sup>

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<sup>16</sup> As noted previously, proposed CBOE Rules 24A.4(b) and 24B.4(b) would not permit the monthly return cap to exceed 25.95%.

<sup>17</sup> A theoretical pricing model would continue to be used to derive position values at each valuation point for the purpose of determining the gain or loss. Currently the only model that qualifies is OCC's TIMS.



### Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX, XXIV, XXIVA and XXIVB would equally apply to Asian and Cliquet options. For example, per Rule 6.1A (Extended Trading Hours), Asian and Cliquet options would not be eligible for trading during Extended Trading Hours. Also, for example, Rules 24A.7 and 24A.8 set forth the position limits and reporting requirements applicable to FLEX Broad-Based Index options and Rules 24A.7 and 24B.7 set forth the exercise limits applicable to FLEX Broad-Based Index options. Respecting positions and exercise limits, these provisions set forth general rules and carve-outs for certain broad-based FLEX Broad-Based Index options, which would apply with equal force to Asian and Cliquet options.

### Surveillance

The Exchange would use the same surveillance procedures currently utilized for the Exchange's other FLEX Broad-Based Index options to monitor trading in Asian and Cliquet options. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in options on these option products. For surveillance purposes, the Exchange will have complete access to information regarding trading activity in the pertinent underlying securities.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>18</sup> Specifically, the Exchange believes the proposed rule change is

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<sup>18</sup> 15 U.S.C. 78f(b).

consistent with the Section 6(b)(5)<sup>19</sup> requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Exchange believes that the proposed rule change is designed to promote just and equitable principles of trade in that the availability of Asian and Cliquet FLEX Broad-Based Index options would give market participants greater flexibility in determining where they will execute their customized options. By trading a product in an exchange traded environment (that is currently being used extensively in the OTC market) would also enable the Exchange to compete more effectively with the OTC market.

The Exchange believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices in that it would hopefully lead to the migration of options currently trading in the OTC market to trading to the Exchange and the development of more standardized products. Also, any migration to the Exchange would result in increased market transparency.

Additionally, the Exchange believes that the proposed rule change is designed to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest in that it should create greater trading and hedging opportunities and flexibility. The proposed rule change should also result in enhanced efficiency in initiating and closing out positions and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of FLEX Broad-Based Index

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<sup>19</sup> 15 U.S.C. 78f(b)(5).

options. Further, the proposal would result in increased competition by permitting the Exchange to offer products that are currently used extensively in the OTC market.

The Exchange believes that the proposed strategy-based margin requirements for Asian and Cliquet options are consistent with the Act because they are designed to protect investors and the public interest by setting margin levels at appropriate levels for these instruments. First, the proposed options are limited to broad-based indexes and the index on which the Exchange expects the most interest is the S&P 500 Index, which has deep and liquid markets. Second, the short option margin levels proposed to be established would apply to retail customers, whom the Exchange does not believe to be the primary sellers (i.e., writers) of the proposed options. Third, as to short Asian and Cliquet positions, the Exchange notes that the proposed margin levels would start at the same level that is required for regular options on broad-based indexes (15%) and would incrementally decrease over time. The Exchange believes that the incremental decrease over time is appropriate given the nature of the proposed options (i.e., the risk associated with the options decreases as the time to expiration nears). Also, the Exchange represents that it conducted an extensive analysis over various time periods when considering the proposed margin levels and represents that for each percentage movement observed, the proposed margin level percentages closely track the percentage movements observed. In other words, the Exchange is proposing conservative and well-founded margin levels for the proposed options. As a result, the Exchange believes that the proposed margin levels would protect the integrity of the Exchange's marketplace by setting margins at levels that are appropriate for these instruments.

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 not necessary or appropriate in furtherance of the purposes of the Act. Specifically, CBOE believes that the introduction of new settlement types (Asian and Cliquet) for FLEX Broad-Based Index options would enhance competition among market participants and would also enable the Exchange to compete more effectively with the OTC market by offering a product that is currently use extensively in the OTC market.

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 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

A. by order approve or disapprove 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2015-044 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-2015-044. 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 website (<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 website viewing and printing 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 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-2015-044 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.<sup>20</sup>

Robert W. Errett  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).