

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53266; File No. SR-CBOE-2005-59)

February 9, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to Listing Standards for Broad-Based Index Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 3, 2005, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below. On October 24, 2005, the CBOE filed Amendment No. 1 to the proposed rule change.³ On February 6, 2006, the CBOE filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to amend its rules to adopt generic listing standards for broad-based index options. The text of the proposed rule change is available on CBOE’s Web site (www.cboe.com), at the CBOE’s Office of the Secretary, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaces the original filing in its entirety, includes several non-substantive revisions that provide clearer and more accurate listing standards.

⁴ Amendment No. 2 makes a technical revision to CBOE Rule 24.2(a) to include a reference to proposed new paragraph 24.2(f), which was inadvertently omitted from the original rule filing and Amendment No. 1.

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 CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below.

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

1. Purpose

The CBOE proposes to adopt CBOE Rule 24.2(f) to establish initial listing standards for broad-based index options. The proposal will allow the CBOE to list, pursuant to Rule 19b-4(e) under the Act,⁵ broad-based index options that meet the initial listing standards in CBOE Rule 24.2(f). The listing standards require that the underlying index be broad-based, as defined in CBOE Rule 24.1(i)(1);⁶ that options on the index be a.m.-settled; that the index be capitalization-weighted, modified capitalization-weighted, price-weighted, or equal dollar-weighted; and that the index be comprised of at least 50 securities, all of which must be "NMS stocks," as defined in Rule 600 of Regulation NMS.⁷ In addition, CBOE Rule 24.2(f) requires that: the index's

⁵ 17 CFR 240.19b-4(e).

⁶ CBOE Rule 24.1(i)(1) defines "broad-based index" to mean "an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries."

⁷ See proposed CBOE Rules 24.2(f)(1), (2), (3), (4) and (9). Rule 600 of Regulation NMS defines an "NMS stock" to mean "any NMS security other than an option." An "NMS security" is defined as "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options." See 17 CFR 242.600.

component securities meet certain minimum market capitalization,⁸ eligibility,⁹ and average daily trading volume requirements;¹⁰ no single component security account for more than 10% of the weight of the index and that the five highest weighted component securities represent no more than 33% of the weight of the index in the aggregate;¹¹ non-U.S. component securities that are not subject to comprehensive surveillance agreements represent no more than 20% of the weight of the index in the aggregate;¹² the index value be widely disseminated at least once every 15 seconds by the Options Price Reporting Authority (“OPRA”), the Consolidated Tape Association Plan/Consolidated Quotation Plan (“CTA/CQ”), the Nasdaq Index Dissemination Service (“NIDS”) or by one or more major market data vendors during the time options on the index are traded on the Exchange;¹³ the Exchange reasonably believes it has adequate system capacity to support the trading of options on the index;¹⁴ an equal dollar-weighted index is

⁸ See proposed CBOE Rule 24.2(f)(5), which requires that component securities that account for at least 95% of the weight of the index have a market capitalization of at least \$75 million, except that component securities that account for at least 65% of the weight of the index have a market capitalization of at least \$100 million.

⁹ See proposed CBOE Rule 24.2(f)(6), which requires that component securities that account for at least 80% of the weight of the index satisfy the requirements of Rule 5.3 applicable to individual underlying securities. CBOE Rule 5.3 requires in part that underlying securities of options listed and traded on the CBOE be “NMS stocks” as defined in Rule 600 of Regulation NMS, 17 CFR 242.600, and have at least a 7 million share float, 2000 holders, total annual trading volume of 2.4 million shares and a minimum price of \$3 per share, and that the issuer must be in compliance with its obligations under the Act.

¹⁰ See proposed CBOE Rule 24.2(f)(7), which requires that each component security that accounts for at least 1% of the weight of the index has an average daily trading volume of at least 90,000 shares during the last six month period.

¹¹ Proposed CBOE Rule 24.2(f)(8).

¹² Proposed CBOE Rule 24.2(f)(10).

¹³ Proposed CBOE Rule 24.2(f)(11).

¹⁴ Proposed CBOE Rule 24.2(f)(12).

rebalanced at least once every calendar quarter;¹⁵ if an index is maintained by a broker-dealer, the index is calculated by a third-party who is not a broker-dealer, and the broker-dealer has erected an informational barrier around its personnel who have access to information concerning changes in, and adjustments to, the index;¹⁶ and that the CBOE have written surveillance procedures in place with respect to the index options.¹⁷

The CBOE also proposes to adopt CBOE Rule 24.2(g), which establishes maintenance standards for broad-based index options listed pursuant to CBOE Rule 24.2(f). Specifically, under proposed CBOE Rule 24.2(g)(1), the requirements set forth above must continually be satisfied, except that the minimum market capitalization, eligibility, and average daily trading volume requirements outlined above, and the requirement that no single component security account for more than 10% of the weight of the index and that the five highest weighted component securities represent no more than 33% of the weight of the index in the aggregate, must be satisfied only as of the first day of January and July of each calendar year. In addition, proposed CBOE Rule 24.2(g)(2) provides that the number of component securities in the index (which initially must be at least 50) may not increase or decrease by more than 10% from the number of component securities in the index at the time of its initial listing. If the option fails to meet these maintenance standards, the CBOE may not open for trading any additional series of options of that class unless the continued listing of the class of index options has been approved by the Commission under Section 19(b)(2) of the Act.¹⁸

¹⁵ Proposed CBOE Rule 24.2(f)(13).

¹⁶ Proposed CBOE Rule 24.2(f)(14).

¹⁷ Proposed CBOE Rule 24.2(f)(15).

¹⁸ 15 U.S.C. 78s(b)(2).

In addition, the CBOE proposes to apply current CBOE Rule 24.4(a), which establishes a position limit of 25,000 contracts on the same side of the market, with a restriction of no more than 15,000 contracts in the near-term series, to broad-based index options listed pursuant to CBOE Rule 24.2(f). Options listed pursuant to proposed CBOE Rule 24.2(f) will, in all other aspects, be traded pursuant to the Exchange's trading rules and procedures applicable to index options, and be covered under the Exchange's existing surveillance procedures for index options.

2. Statutory Basis

CBOE believes the proposed rule change is consistent with Section 6(b)¹⁹ of the Act in general and furthers the objectives of Section 6(b)(5)²⁰ in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. According to CBOE, the adoption of the proposed rule change will enable CBOE to act expeditiously in listing options on new broad-based security indexes in the same manner currently afforded to narrow-based indexes as defined under Rule 24.2(b). In addition, CBOE believes that the proposed rule change will remove impediments to a free and open market place by providing competition for new products. CBOE further believes that the proposed rule change will permit CBOE to more effectively bring new products to the marketplace for competition, as well as permit CBOE to compete with other new products that may be introduced to the marketplace.

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

¹⁹ 15 U.S.C. 78f(b).

²⁰ 15 U.S.C. 78f(b)(5).

CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither received nor solicited written comments on the proposal.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2005-59 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2005-59. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be

available for inspection and copying in the Commission's Public Reference Room. 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-2005-59 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.²¹ In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,²² 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.

To list options on a particular broad-based index, the CBOE currently must file a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Act²³ and Rule 19b-4 thereunder.²⁴ However, Rule 19b-4(e)²⁵ provides that the listing and trading of a new

²¹ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²² 15 U.S.C. 78f(b)(5).

²³ 15 U.S.C. 78s(b)(1).

²⁴ 17 CFR 240.19b-4.

²⁵ 17 CFR 240.19b-4(e).

derivative securities product by a self-regulatory organization (“SRO”) will not be deemed a proposed rule change pursuant to Rule 19b-4(c)(1)²⁶ if the Commission has approved, pursuant to Section 19(b) of the Act,²⁷ the SRO’s trading rules, procedures, and listing standards for the product class that would include the new derivative securities product, and the SRO has a surveillance program for the product class.

As described more fully above and in CBOE’s filing, the CBOE proposes to establish listing standards for broad-based index options. The Commission’s approval of the CBOE’s listing standards for broad-based index options will allow options that satisfy the listing standards to begin trading pursuant to Rule 19b-4(e),²⁸ without constituting a proposed rule change within the meaning of Section 19(b) of the Act²⁹ and Rule 19b-4 thereunder,³⁰ for which notice and comment and Commission approval is necessary.³¹ The CBOE’s ability to rely on Rule 19b-4(e)³² to list broad-based index options that meet the requirements of CBOE Rule 24.2(f) potentially reduces the time frame for bringing these securities to the market, thereby promoting competition and making new broad-based index options available to investors more

²⁶ 17 CFR 240.19b-4(c)(1).

²⁷ 15 U.S.C. 78s(b).

²⁸ 17 CFR 240.19b-4(e).

²⁹ 15 U.S.C. 78s(b).

³⁰ 17 CFR 240.19b-4.

³¹ When relying on Rule 19b-4(e), 17 CFR 240.19b-4(e), the SRO must submit Form 19b-4(e) to the Commission within five business days after the SRO begins trading the new derivative securities product. See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

If the underlying index does not satisfy all of the conditions in the listing standards contained in proposed CBOE Rule 24.2(f), the CBOE would be required to file a proposed rule change with the Commission pursuant to Section 19(b)(2) of the Act, 15 U.S.C. 78s(b)(2), and obtain Commission approval to list options on that index.

³² 17 CFR 240.19b-4(e).

quickly.

The Commission notes that the CBOE has represented that it has adequate trading rules, procedures, listing standards, and a surveillance program for broad-based index options. CBOE's existing index option trading rules and procedures will apply to broad-based index options listed pursuant to CBOE Rule 24.2(f). Other existing CBOE rules, including provisions addressing sales practices and margin requirements, also will apply to these options. In addition, the CBOE proposes to establish position and exercise limits of 25,000 contracts on the same side of the market, with a restriction of no more than 15,000 contracts in the near-term series, for broad-based index options listed pursuant to CBOE Rule 24.2(f), by applying CBOE Rule 24.4(a) to such options.³³ The Commission believes that the proposed position and exercise limits should serve to minimize potential manipulation concerns.

The CBOE represents that it has adequate surveillance procedures for broad-based index options and that it intends to apply its existing surveillance procedures for index options to monitor trading in broad-based index options listed pursuant to CBOE Rule 24.2(f). In addition, because CBOE Rule 24.2(f) requires that each component of an index be an "NMS stock," as defined in Rule 600 of Regulation NMS under the Act,³⁴ each index component must be listed on a registered national securities exchange or Nasdaq. Accordingly, the CBOE will have access to information concerning trading activity in the component securities of an underlying index through the Intermarket Surveillance Group ("ISG").³⁵ CBOE Rule 24.2(f) also provides that

³³ See CBOE Rule 24.4(a). Under CBOE Rule 24.5, the exercise limits for index option contracts are equivalent to the position limits prescribed for option contracts with the nearest expiration date in CBOE Rule 24.4 or 24.4A.

³⁴ 17 CFR 242.600.

³⁵ The ISG was formed on July 14, 1983, to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. All of the registered national securities exchanges and the National

non-U.S. index components that are not subject to a comprehensive surveillance sharing agreement between the CBOE and the primary market(s) trading the index components may comprise no more than 20% of the weight of the index.³⁶ The Commission believes that these requirements will help to ensure that the CBOE has the ability to monitor trading in broad-based index options listed pursuant to CBOE Rule 24.2(f) and in the component securities of the underlying indexes.

The Commission believes that the requirements in CBOE Rule 24.2(f) regarding, among other things, the minimum market capitalization, trading volume, and relative weightings of an underlying index's component stocks are designed to ensure that the markets for the index's component stocks are adequately capitalized and sufficiently liquid, and that no one stock dominates the index. In addition, CBOE Rule 24.2(f) requires that the underlying index be "broad-based," as defined in CBOE Rule 24.1(i)(1).³⁷ The Commission believes that these requirements minimize the potential for manipulating the underlying index.

The Commission believes that the requirement in CBOE Rule 24.2(f) that the current index value be widely disseminated at least once every 15 seconds by OPRA, CTA/CQ, NIDS, or by one or more major market data vendors during the time an index option trades on the CBOE should provide transparency with respect to current index values and contribute to the transparency of the market for broad-based index options. In addition, the Commission believes, as it has noted in other contexts, that the requirement in CBOE Rule 24.2(f) that an index option

Association of Securities Dealers, Inc., are members of the ISG. In addition, futures exchanges and non-U.S. exchanges and associations are affiliate members of the ISG.

³⁶ However, such non-U.S. index components, as "NMS stocks," would be registered under Section 12 of the Act, 15 U.S.C. 78j, and listed and traded on a national securities exchange or Nasdaq, where there is last sale reporting.

³⁷ See supra note 6.

be settled based on the opening prices of the index's component securities, rather than on closing prices, could help to reduce the potential impact of expiring index options on the market for the index's component securities.³⁸

The Exchange has requested accelerated approval of the proposed rule change. The Commission finds good cause for approving the proposed rule change, as amended, prior to the 30th day after the date of publication of the notice of filing in the Federal Register. The proposal implements listing and maintenance standards and position and exercise limits for broad-based index options substantially the same as those recently approved for the International Securities Exchange, which were subject to the full public comment period, with no comments received.³⁹ The Commission does not believe that the Exchange's proposal raises any novel regulatory issues. Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,⁴⁰ to approve the proposed rule change, as amended, on an accelerated basis.

³⁸ See, e.g., Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (order approving a CBOE proposal to establish opening price settlement for S&P 500 Index options).

³⁹ See Securities Exchange Act Release No. 52578 (October 7, 2005), 70 FR 60590 (October 18, 2005). See also Securities Exchange Act Release No. 52781 (November 16, 2005), 70 FR 70898 (November 23, 2005) (order approving on an accelerated basis generic broad-based index option listing standards for the American Stock Exchange).

⁴⁰ 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴¹ that the proposed rule change (SR-CBOE-2005-59), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴²

Nancy M. Morris
Secretary

⁴¹

Id.

⁴²

17 CFR 200.30-3(a)(12).