

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55491; File No. SR-CBOE-2006-95)

March 19, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment Nos. 1 and 2 Thereto to List for Trading Options on the Vanguard[®] Emerging Markets Exchange Traded Fund

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 November 30, 2006, 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, which Items have been substantially prepared by the Exchange. The Exchange submitted Amendment No. 1 to the proposed rule change on December 6, 2006. The Exchange submitted Amendment No. 2 to the proposed rule change on February 28, 2007. The Commission is publishing this notice and order to solicit comments on the proposal, as amended, from interested persons and to approve the proposed rule change, as modified by Amendment Nos. 1 and 2, on an accelerated basis.

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

The Exchange proposes to list and trade options on the on the Vanguard[®] Emerging Markets Exchange Traded Fund (“Fund Options”). The text of the proposed rule change is available on the Exchange's website (<http://www.cboe.org/legal>), at the Office of the Secretary, CBOE and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change. The text of these statements may be examined at the places specified in Item III 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 rule change is to obtain approval to list for trading on the Exchange options on the Vanguard[®] Emerging Markets Exchange Traded Fund ("Fund") on a pilot basis for six months to commence on the date of approval and through six months after that date. The Exchange currently has in place initial listing and maintenance standards set forth in CBOE Rules 5.3.06 and 5.4.08, respectively ("Listing Standards") that are designed to allow the Exchange to list funds structured as open-end investment companies, such as the Fund, without having to file for Commission approval to list for trading options on the fund.³ The request for approval is based on the Exchange's determination that the Fund meets substantially all of the Listing Standards requirements, and for the requirements that are not met, sufficient mechanisms

³ CBOE Rules 5.3.06 and 5.4.08 set forth the initial listing and maintenance standards for registered investment companies (or series thereof) organized as open-end management investment companies, unit investment trust or other similar entities traded on a national securities exchange or through the facilities of a national securities exchange ("Exchange Traded Funds"). See Exchange Act Release, No. 34-40166 (July 2, 1998), 63 FR 37430 (July 10, 1998) (approval order for SR-CBOE-97-45, predating U.S. Securities and Exchange Commission's ("Commission") adoption of Rule 19b-4(e) of the Securities Exchange Act of 1934 ("New Product Release"). See Exchange Act Release No. 34-40761 (Dec. 8, 1998), 63 FR 70952 (Dec. 22, 1998)).

exist that would provide the Exchange with adequate surveillance and regulatory information with respect to the Fund.

As provided in the Fund's most recent prospectus, dated November 10, 2006, the Fund is an open-end investment company that is designed to hold a portfolio of securities that tracks the Morgan Stanley Capital International, Inc. Emerging Markets Index ("MSCI Emerging Markets Index" or "Index"), which includes approximately 850 common stocks of companies located in 25 emerging markets around the world.⁴ The Fund employs a "passive management" – or indexing – investment approach by investing substantially all (normally about 95%) of its assets in the common stocks that comprise the MSCI Emerging Markets Index while employing a form of sampling to reduce risk.

As of January 31, 2007, the Fund was comprised of 862 securities and the ten largest holdings in the fund made up 18.5% of the total assets in the Fund.⁵ The security with the greatest individual weight of 5.4% is OAO Gazprom ADR Samsung Electronics Co LTD GDR Registered, a South Korean Russian security. The security with the smallest weight is Thanachart

⁴ As provided by Morgan Stanley Capital International, Inc. ("MSCI"), which is the entity that created and currently maintains the Index, the Index is a capitalization-weighted index whose component securities are adjusted for available float and must meet objective criteria for inclusion in the Index. The Index aims to capture 85% of the publicly available total market capitalization in each emerging market included in the Index. As of September 29, 2006, the Index was comprised of 852 constituents with the top five constituents representing the following weights: 5.01%, 4.09%, 1.82%, 1.79%, and 1.76%. The Index is rebalanced quarterly, calculated in U.S. Dollars on a real time basis, and disseminated every 60 seconds during market trading hours.

⁵ The ten largest holdings are: (1) OAO Gazprom ADR, (2) Samsung Electronics Co., Ltd., (3) China Mobile (Hong Kong), Ltd., (4) America Movil SA de CV, (5) Lukoil Sponsored ADR; (6) Taiwan Semiconductor Manufacturing Co., Ltd., (7) Petroleo Brasileiro SA Pfd (8) Hon Hai Precision Industry Co., Ltd., (9) Cemex SA CPO, and (1) Petroleo Brasileiro SA. See <https://flagship.vanguard.com/VGApp/hnw/FundsSnapshot?FundId=0964&FundIntExt=INT>.

Capital Public Company Ltd., Metropolitan Bank & Trust Coa Thai security, at less than 0.01%.

As of January 31, 2007, the largest markets covered in the Fund were South Korea (14.9%), Taiwan (12.3%), Russia (9.9%), Brazil (10.7%) and South Africa (8.5%).

The Exchange believes that Vanguard's stated investment policies prevent the Fund from being excessively weighted in any single security or small group of securities and significantly reduces concerns that trading in the Fund could become a surrogate for trading in unregistered securities.

Shares of the Fund ("Fund Shares") are issued in exchange for an "in kind" deposit of a specified portfolio of securities, together with a cash payment, in minimum size aggregation of 100,000 shares (each, a "Creation Unit"), as set forth in the Fund's prospectus.⁶ The Fund issues and sells Fund Shares in Creation Unit sizes through a principal underwriter on a continuous basis at the net asset value per share next determined after an order to purchase Fund Shares and the appropriate securities are received. Following issuance, Fund Shares are traded on an exchange like other equity securities, and equity-trading rules apply. Likewise, redemption of Fund Shares is made in Creation Unit size and "in kind," with a portfolio of securities and cash exchanged for Fund Shares that have been tendered for redemption.

The Exchange notes that the maintenance Listing Standards set forth in Rule 5.4.08 for open-end investment companies do not include criteria based on either the number of shares or other units outstanding or on their trading volume. As explained in SR-CBOE-97-03,⁷ the absence of such criteria is justified on the ground that since it should always be possible to create

⁶ See Exchange Act Release No. 34-44990, n.16 (Oct. 25, 2001), 66 FR 56869 (Nov. 13, 2001) (approval order for SR-Amex-2001-45, noting that local restrictions on transfers of securities to and between certain kinds of investors exist in certain foreign markets that preclude in-kind creation and redemptions of Exchange-Traded Funds).

⁷ See Securities Exchange Act Release No. 40166 (July 2, 1998), 63 FR 37430 (July 10, 1998).

additional shares or other interests in open-end investment companies at their net asset value by making an in-kind deposit of the securities that comprise the underlying index or portfolio, there is no limit on the available supply of such shares or interests. This, in turn, should make it highly unlikely that the market for listed, open-end investment company shares could be capable of manipulation, since whenever the market price for such shares departs from net asset value, arbitrage will occur. Similarly, since the Fund meets all of the requirements of the Listing Standards, except as described below, the Exchange believes that the same analysis applies to the Fund.

The Exchange has reviewed the Fund and determined that it satisfies the Listing Standards, except for the requirement set forth in CBOE Rule 5.3.06(A), which requires the Fund to meet the following condition: "any non-U.S. component securities of the index or portfolio on which the Units are based that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio." The Exchange currently has in place comprehensive surveillance sharing agreements ("CSSA") with foreign exchanges that cover 48.10% of the securities in the Fund. One of the foreign exchanges on which component securities of the Fund are traded and with which the Exchange does not have a CSSA is the Bolsa Mexicana de Valores ("Bolsa"). The percentage of the weight of the Fund represented by these securities is 6.60%.

The Exchange notes that the Commission recently approved the listing and trading of options on the iShares MSCI Emerging Markets Index Fund on a on a pilot basis⁸ and permitted

⁸ See Exchange Act Release No. 34-53621 (April 10, 2006), 71 FR 79568 (April 14, 2006) (approving 60 day pilot listing and trading, until June 9, 2006); see also Exchange Act Release No. 34-53960 (June 1, 2006), 71 FR 33322 (June 8, 2006) (continuation of pilot program for additional 90 days, until September 7, 2006); see also Exchange Act Release No. 34-54347 (Aug. 22, 2006), 71 FR 51242 (Aug. 29, 2006) (continuation of pilot

the Exchange to rely on the memorandum of understanding executed by the Commission and the CNBV, dated as of October 18, 1990 ("MOU") for purposes of satisfying its surveillance and regulatory responsibilities for the component securities in the Fund that trade on the Bolsa until the Exchange is able to secure a surveillance agreement with the Bolsa.⁹

Specifically, in connection with the listing and trading of options on the iShares MSCI Emerging Markets Index Fund, the Exchange contacted the Bolsa with a request to enter into a CSSA. In response, the Bolsa expressed a willingness to enter into a surveillance sharing agreement but indicated that it was unable to provide certain information that is required as part of a CSSA. As a result of being unable to secure a CSSA with the Bolsa, the Exchange requested permission to rely for a pilot period on the MOU and the Exchange agreed to use its best efforts that during this period to obtain a CSSA with the Bolsa, which would reflect the following: (1) Express language addressing market trading activity, clearing activity, and customer identify; (2) the Bolsa's reasonable ability to obtain access to and produce requested information; and (3) based on the CSSA and other information provided by the Bolsa, the absence of existing rules, law or practices that would impede the Exchange from obtaining foreign information relating to market activity, clearing activity, or customer identity, or in the event such rules, laws, or practices exist, they would not materially impede the production of customer or other information.

program for additional 90 days, until December 7, 2006); see also Exchange Act Release No. 34-54876 (Dec. 5, 2006), 71 FR 74968 (Dec. 13, 2006) (continuation of pilot program for additional six months, until June 7, 2007).

⁹ The CNBV is the successor to the Comision Nacional y de Valores of Mexico, which was merged with the Mexican Banking Commission in April 1995 to form the CNBV. See Exchange Act Release No. 36415, at n.23 (Oct. 25, 1995), 60 FR 55620 (Nov. 1, 1995) (approval order for SR-CBOE-95-045). The Bolsa falls within the regulatory oversight of CNBV.

On other occasions, the Commission has been willing to allow an exchange to rely on a memorandum of understanding entered into between regulators in the event that the exchanges themselves cannot enter into a CSSA. For example, the Exchange previously attempted to enter into a CSSA with the Bolsa around the time the Exchange sought approval to list for trading options on the CBOE Mexico 30 Index in 1995, which was comprised of stocks trading on the Bolsa.¹⁰ Since the Bolsa was unable to provide a CSSA, the Commission allowed the Exchange to rely on the on the MOU between the SEC and CNBV.

The Commission noted in the Approval Order regarding the CBOE Mexico 30 Index that, in cases where it would be impossible to secure a CSSA, the Commission has relied in the past on surveillance sharing agreements between the relevant regulators. The Commission further noted in the Approval Order that, pursuant to the terms of the MOU, it was the Commission's understanding that both the Commission and the CNBV could acquire information from and provide information to the other, similar to that which would be required in a CSSA between exchanges. Therefore, should CBOE need information on Mexican trading in the component securities of the CBOE Mexico 30 Index, the Commission could request such information from the CNBV under the MOU.

The practice of relying on surveillance agreements between regulators when a foreign exchange was unable or unwilling to provide a CSSA was affirmed by the Commission in the Commission's New Product Release.¹¹ In the New Product Release, the Commission noted that if securing an information sharing agreement is not possible, an exchange should contact the Commission prior to listing a new derivative securities product. The Commission also noted that

¹⁰ See Exchange Act Release No. 36415 (Oct. 25, 1995), 60 FR 55620 (Nov. 1, 1995) (approval order for SR-CBOE-95-045).

¹¹ See n. 4, *supra*.

the Commission might determine instead that it is appropriate to rely on a memorandum of understanding between the Commission and the foreign regulator.

Given the Exchange's current inability to enter into a CSSA with the Bolsa, the Exchange requests permission to rely on a pilot basis on the MOU entered into between the Commission and the CNBV for purposes of satisfying its surveillance and regulatory responsibilities for the component securities in the Fund that trade on the Bolsa until the Exchange is able to secure a CSSA with the Bolsa. The Exchange believes this request is reasonable because the Commission has already acknowledged that the MOU permits both the Commission and the CNBV to acquire information from and provide information to the other, which is similar to that which would be required in a surveillance sharing agreement between exchanges.

Additionally, if the Commission approves the listing of the Fund on a pilot basis, during this period, the Exchange represents that it will continue its efforts to obtain a CSSA with the Bolsa. The Exchange also represents that it will regularly update the Commission on the status of its discussions with the Bolsa. The Commission's approval of this request would otherwise render the Fund compliant with all of the Listing Standards.¹²

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act¹³ and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.¹⁴ Specifically, the Exchange believes the proposed rule

¹² The Exchange notes that the component securities of the Fund change periodically. Therefore, the Exchange may in fact have in place CSSAs that would otherwise cover the percent weighting requirements set forth in the Listing Standards for securities not trading on the Bolsa. In this event, the Fund would satisfy all of the Listing Standards and reliance on an approval order for the Fund would be unnecessary.

¹³ 15 U.S.C. 78a et seq.

¹⁴ 15 U.S.C. 78(f)(b).

change is consistent with the Section 6(b)(5)¹⁵ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

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

The Exchange 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

No written comments were solicited or received with respect to the proposed rule change.

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-2006-95 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-2006-95. 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

¹⁵ 15 U.S.C. 78(f)(b)(5).

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 offices of the Exchange. 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-2006-95 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

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.¹⁶ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹⁷ which requires that an exchange have rules designed, among other things, 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.

¹⁶ In approving this rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b)(5).

The listing of the Fund Options does not satisfy CBOE Rule 5.3.06(A), which requires that: “any non-U.S. component securities of the index or portfolio on which the Units are based that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio.” Although the Commission has been willing to allow an exchange to rely on a memorandum of understanding entered into between regulators where the listing SRO finds it impossible to enter into an information sharing agreement, it is not clear that that CBOE has exhausted all avenues of discussion with foreign markets, including Bolsa, in order to obtain such an agreement. Indeed, with regard to Bolsa, conditions may have changed in the time period since CBOE last raised the issue with Bolsa in 1995 such that Bolsa now would be able to entering a comprehensive surveillance agreement with CBOE.

Consequently, the Commission has determined to approve CBOE’s listing and trading of Fund Options for a six-month pilot period during which time CBOE may rely on the MOU with respect to Fund components trading on Bolsa. During this period, the Exchange has agreed to use its best efforts to obtain a comprehensive surveillance agreement with Bolsa, which shall reflect the following: (1) Express language addressing market trading activity, clearing activity, and customer identify; (2) the Bolsa's reasonable ability to obtain access to and produce requested information; and (3) based on the CSSA and other information provided by the Bolsa, the absence of existing rules, law or practices that would impede the Exchange from obtaining foreign information relating to market activity, clearing activity, or customer identity, or in the event such rules, laws, or practices exist, they would not materially impede the production of customer or other information.

The Exchange also represents that it will regularly update the Commission on the status of its negotiations with Bolsa. In approving the proposed rule change, the Commission notes that CBOE currently has in place surveillance agreements with foreign exchanges that cover 48.10% of the securities in the Fund and that the Index upon which the Fund is based appears to be a broad-based index.

The Exchange has requested accelerated approval of the proposed rule change. The Commission finds good cause, consistent with Section 19(b)(2) of the Act,¹⁸ for approving this proposed rule change before the thirtieth day after the publication of notice thereof in the Federal Register. The Exchange has agreed to use its best efforts to obtain a comprehensive surveillance agreement with the Bolsa during a six-month pilot period in which the Exchange will rely on the MOU.

¹⁸ 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-CBOE-2006-95), as modified by Amendment Nos. 1 and 2, be, and it hereby is approved on an accelerated basis for a six-month pilot period ending on September 19, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Florence E. Harmon
Deputy Secretary

¹⁹

Id.

²⁰

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