SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64991; File No. SR-CBOE-2011-039)

July 29, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of Proposed Rule Change to List and Trade Single Stock Dividend Options

On May 31, 2011, the Chicago Board Options Exchange, Incorporated ("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] and Rule 19b-4 thereunder,[2] a proposed rule change to list and trade cash-settled options that overlie the ordinary cash dividends paid by an issuer over an annual, semi-annual, or quarterly "accrual period." The proposed rule change was published for comment in the Federal Register on June 17, 2011.[3] The Commission received no comments on the proposal. This order approves the proposed rule change.

I. Description of Proposal

CBOE proposes to list and trade cash-settled, P.M.-settled, European-style exercise options that overlie the ordinary cash dividends paid by an issuer ("SSDO") over an annual accrual period. CBOE also may list series of SSDOs with an accrual period of less than a year, but in no event less than one quarter of a year.

Product Design

Each SSDO represents the accumulated ordinary dividend amounts paid by a specific

---

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

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 64654 (June 13, 2011), 76 FR 35503 ("Notice").

issuer over a specified accrual period.[4] Each annual accrual period will run from the business day after the third Friday of December through the third Friday of the following December. For an SSDO with an accrual period of less than a year, the accrual period runs from the business day after the third Friday of the month beginning the accrual period through the third Friday of the month ending the accrual period.[5]

The underlying value for SSDOs will be equal to ten (10) times the ex-dividend amounts of an issuer accumulated over the specified accrual period. Each day, CBOE will calculate the aggregate daily dividend totals for the specific issuer, which are summed up over any accrual period. During each business day, CBOE will disseminate the underlying SSDO value, multiplied by ten (10), through the Options Price Reporting Authority ("OPRA"), the Consolidated Tape Association ("CTA") tape and/or the Market Data Index ("MDI") feed.

Options Trading

Each SSDO will be quoted in decimals and one point will be equal to $100. The Exchange proposes that the minimum price variation for quotes shall be established on a class-by-class basis by the Exchange and shall not be less than $0.01. CBOE also proposes to list series at 1 point ($1.00) or greater strike price intervals if the strike price is equal to or less than $200 and 2.5 points ($2.50) or greater strike price intervals if the strike price exceeds $200.

Initially, the Exchange will list in-, at- and out-of-the-money strike prices and may open for trading up to five annual contract months expiring in December in different years for any single stock underlying an SSDO and up to ten contract months for accrual periods of less than a year.[6]

---

4 For purposes of SSDOs, dividends are deemed to be "paid" on the ex-dividend date.

5 The Exchange will assign separate trading symbols to SSDOs overlying the accumulated ex-dividends of the same issuer that have different accrual periods.

6 See Notice, supra note 3, for an example of listing five annual contract months expiring in December in different years.

The Exchange is proposing to use the expected dividend (i.e., the aggregate value of dividends that are expected to be paid by the issuer over a given accrual period) amount for setting the initial strikes. Near-term SSDOs will reflect dividends accumulating in the then-current accrual period. All other SSDO options (i.e., contracts listed for trading that are not in the then-current accrual period) will reflect dividends expected in comparable accrual periods beyond the current accrual period. The Exchange may open for trading additional series, either in response to customer demand or as the price of the expected dividends for an issuer changes.

Exercise and Settlement

The proposed options will expire on the Saturday following the third Friday of the expiring month. Trading in the expiring contract month will normally cease at 3:00 p.m. Chicago time on the last day of trading (ordinarily the Friday before expiration Saturday, unless there is an intervening holiday). When the last trading day is moved because of an Exchange holiday (such as when CBOE is closed on the Friday before expiration), the last trading day for expiring options will be Thursday.

Exercise will result in delivery of cash on the business day following expiration. SSDOs will be P.M.-settled. The Exchange is proposing P.M.-settlement for SSDOs because options trading on individual stocks are P.M. settled. As a result, the Exchange is proposing to match the expiration style for SSDOs to individual stock option exercise. The exercise-settlement amount will be equal to ten times the ordinary cash dividends paid by the issuer over the accrual period. The exercise settlement amount is equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by the contract multiplier ($100).

If the exercise settlement value is not available or the normal settlement procedure cannot be utilized due to a trading disruption or other unusual circumstance, the settlement value will be determined in accordance with the rules and bylaws of the OCC.

Surveillance

CBOE has represented that it will use the same surveillance procedures currently utilized for each of the Exchange's other single stock options to monitor trading in SSDOs. Such procedures include, for example, monitoring dividend announcements. The Exchange represents that these surveillance procedures shall be adequate to monitor trading in these option products. For surveillance purposes, the CBOE has represented that it will have complete access to information regarding trading activity in the pertinent securities whose dividend payment is the basis for particular SSDOs.

Position Limits

CBOE proposes that position and exercise limits for SSDOs will be the same as those for standard options overlying the same security. While positions in SSDOs will be aggregated with longer-dated positions in SSDOs with the same underlying stock for position and exercise limits purposes, they will not be aggregated with positions in the ordinary options overlying the stock of the issuer paying the dividends underlying the SSDO. CBOE represents that the reason for not aggregating positions with ordinary options is that SSDOs are based solely on expected dividends for an issuer and will reflect the forward value of that expectation. CBOE states that because the pricing of ordinary options versus SSDOs will differ dramatically, the Exchange believes there is no need to aggregate positions to prevent manipulative practices involving the underlying options.

Exchange Rules Applicable

New Rule 5.9 is proposed to govern the listing and trading of SSDOs. In addition, SSDOs will be margined in the same manner as single stock options under Exchange Rule 12.3. Purchasers of puts or calls, however, must be paid in full, even if there remains longer than nine months until expiration for the position. For SSDOs, the aggregate contract value on which the margin amount will be calculated will be the product of the forward expected dividend amount for the accrual period (as adjusted for any contract scaling factor) and the applicable multiplier ($100).

CBOE proposes to designate SSDO options as eligible for trading as Flexible Exchange Options ("FLEX options") as provided for in Chapters XXIVA (Flexible Exchange Options) and XXIVB (FLEX Hybrid Trading System).

Capacity

CBOE represents that it has analyzed its capacity and believes that the Exchange and OPRA have the necessary systems capacity to handle the additional traffic associated with the listing of new series that will result from the introduction of SSDOs.

II. Discussion and Commission Findings

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.[7] Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,[8] which requires, among other things, that the rules of a national securities exchange be designed 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 believes that CBOE's proposal gives options investors the ability to make an additional investment choice in a manner consistent with the requirements of Section

---

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

[8] 15 U.S.C. 78f(b)(5).

6(b)(5) of the Act.[9] The Commission notes that SSDOs will allow market participants to hedge their exposure to changes in the dividend payment policies of the underlying securities. Further, the Commission believes that the listing rules proposed by CBOE for SSDOs are reasonable and consistent with the Act, as discussed below.

The Commission believes that permitting $1.00 strike price intervals if the strike price is equal to or less than $200 will provide investors with added flexibility in the trading of these options and will further the public interest by allowing investors to establish positions that are better tailored to meet their investment objectives. As explained by CBOE, the underlying value of an SSDO is expected to fluctuate around a limited expected dividend value range,[10] and therefore, the implementation of $1.00 strike price intervals is designed to provide investors with flexibility. Because of this characteristic the Commission believes that the implementation of $1 strike price intervals for SSDOs, within the parameters of the rule, is appropriate.

The Commission believes that CBOE's proposal to allow the minimum price variation to be no less than $0.01, as established on a class-by-class basis, is consistent with the Act, given the expected low underlying dividend values for SSDOs. CBOE has represented that it expects that the underlying dividend values for SSDOs will be relatively low, and that granular pricing will provide for more pricing points. Further, CBOE has represented that it has analyzed its capacity and believes that it and OPRA have the necessary systems capacity to handle the additional traffic associated with the listing of new series that will result from the introduction of SSDOs. In particular, the Exchange noted that expected dividend payments, on which the value of SSDOs are predicated, are generally much less volatile than share prices, and thus there is less

---

9 15 U.S.C. 78f(b)(5).

10 The Commission notes that, in the Notice the Exchange provided a number of examples of values underlying SSDOs using past ordinary dividend payouts over varying accrual periods, and these values ranged from 1 to 22.70. See Notice, supra note 3.

need to list numerous strike prices for each expiration date of an SSDO or to add many new strikes over the life of an SSDO.

The Commission notes that, on a daily basis, CBOE will calculate the aggregate daily dividend totals for the specific issuer, and will disseminate the underlying SSDO value, multiplied by ten (10), through OPRA, the CTA and/or the MDI feed.

The Exchange has proposed to apply the same position and exercise limits as those for standard options overlying the same security. However, the Exchange notes that positions in SSDOs will not be aggregated with positions in the ordinary positions overlying the stock of the issuer paying the dividends underlying the SSDO, because the pricing of ordinary options and SSDOs vary greatly and thus it is unnecessary to aggregate the positions to prevent manipulative practices involving the underlying. The Commission believes that CBOE's proposed rules relating to position and exercise limits are appropriate and consistent with the Act.

The Exchange also proposes to margin SSDOs in the same manner as single stock options; however, the aggregate contract value on which the margin amount will be calculated will be the product of the forward expected dividend amount for the accrual period and the applicable modifier. The Commission believes that CBOE's proposed rules relating to margin requirements are appropriate.

The Commission also believes that CBOE's proposal to allow SSDOs 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.[11]

---

[11] See Securities Exchange Act Release No. 31910 (February 23, 1993), 58 FR 12056

The Commission notes that CBOE represented that it has an adequate surveillance program to monitor trading of SSDOs and intends to apply its existing surveillance program for single stock options to support the trading of these options. As with other securities, there is a potential risk that a corporate insider may exploit his or her advance knowledge of changes to an issuer's dividend policy through the purchase or sale of an SSDO. The Commission has taken a number of enforcement actions in cases where insiders executed securities transactions to exploit their knowledge of changes in issuers' dividend policies.[12] Accordingly, adequate surveillance is an important responsibility of the CBOE. In addition, CBOE has represented that it is confident that it has adequate tools in place to surveil for market manipulation. Further, CBOE is a member of the ISG and can obtain trading activity in information in the underlying securities whose dividend payment is the basis for particular SSDOs from the exchanges that list the securities. The Commission believes that CBOE should have the ability and resources to adequately surveil for manipulation in SSDOs.

In approving the proposed rule change, the Commission has also relied upon CBOE's representation that it has the necessary systems capacity to support the new options series that will result from this proposal.

(March 2, 1993).

12 See, e.g., SEC v. David L. Johnson, Civil Action No. 05-CV-4789 (USDC E.D. Pa.) (Sept. 7, 2005) (consent to permanent injunction, disgorgement and civil penalty for a person who allegedly sold shares of an issuer based on inside information of a dividend cut, and tipped his son to do likewise); SEC v. Barry Hertz, Civil Action No. 05-2848 (USDC E.D.N.Y.) (Mar. 16, 2007) (consent to final judgment, including an injunction and two-year bar from serving as an officer or director of a public corporation, for a person alleged to have traded on inside information, including purchasing shares of an issuer while in possession of positive news of a first time dividend issuance).

III. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[13] that the proposed rule change (SR-CBOE-2011-039) is hereby approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[14]

Elizabeth M. Murphy
Secretary

---

13 15 U.S.C. 78s(b)(2).

14 17 CFR 200.30-3(a)(12).