

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70136; File No. SR-CBOE-2013-079)

August 8, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule to Amend Rule 24.7 to Add Facts for Determining Whether to Halt Volatility Index Options Trading

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 July 29, 2013, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III 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

CBOE proposes to amend CBOE Rule 24.7 (Trading Halts, Suspensions, or Primary Market Closure) to add facts that may be considered when determining whether to halt trading in volatility index options.³ 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’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ CBOE calculates and lists options on several volatility indexes comprised of broad-based index options, individual stock options and exchange-traded fund (“ETF”) options. Collectively, these products are known as “volatility index options” for purposes of CBOE’s rules. See CBOE Rule 24.9(a)(5).

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 Exchange now has several years of experience with volatility index derivatives trading and believes that it is appropriate to continually review and revise trading rules for volatility index options. Among other things, Rule 24.7 (Trading Halts, Suspensions, or Primary Market Closure) sets forth several facts that may be considered in determining whether to halt trading in an index option class. Through this filing, CBOE proposes to amend Rule 24.7(a) to add additional facts that may be considered when determining whether to halt trading in volatility index options.

First, CBOE proposes to amend Rule 24.7(a)(i), which permits consideration to be given to “the extent to which trading is not occurring in the stocks underlying the index[.]” Volatility indexes are comprised of options, not stocks. Therefore, CBOE proposes to amend Rule 24.7(a)(i) to permit consideration to be given (in determining whether to halt trading in a volatility index option class) to whether the component options in a volatility index are not trading. For example, the CBOE Volatility Index (“VIX”) is comprised of S&P 500 Index (“SPX”) options. If trading in SPX options were not occurring, this fact may be given consideration in determining whether to halt trading in VIX options. Also, if SPX options are

open for trading, this fact weighs in favor of not halting trading in VIX options. Similarly, the Exchange is proposing to amend Rule 24.7(b) which sets forth factors that may be considered in determining whether to resume trading of a halted class or series. The Exchange proposes to amend the factor regarding the "extent to which trading is occurring in stocks underlying the index" to include options.

Second, CBOE proposes to add a new fact (as subparagraph (iii) to Rule 24.7(a)) for consideration when determining whether to halt trading in volatility index options. Specifically, CBOE proposes to add a provision that would permit consideration to be given (in determining whether to halt trading in a volatility index option class) to whether the "current index level" for a volatility index option is not available or the spot (cash) value for a volatility index option is not available. As described below, the "current index level" would mean the implied forward level based on corresponding volatility index (security) futures prices, which CBOE proposes to define in new Interpretation and Policy .03 to Rule 24.7.⁴

By way of background, option prices reflect the market's expectation of the price of the underlying at expiration, which is referred to as the "forward level." For stock indexes, such as the S&P 500 Index, the best estimate of the forward level is the current, or "spot," price adjusted for the "carry," which is the financing cost of owning the component stocks in the index less the dividends paid by those stocks. For VIX (and other volatility indexes), a better estimate than the standard "cash and carry" model for calculating the forward volatility index levels at each expiration is reflected in the prices of the options that will actually be used to calculate the

⁴ The Exchange notes that futures prices have been used by CBOE in the past to determine the "current index value" for VIX options. See Securities Exchange Act Release No. 54192 (July 21, 2006), 71 FR 43251 (July 31, 2005) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto Relating to Strike Price Intervals for VIX Options) (SR-CBOE-2006-27).

volatility index on a given expiration day. For example, September SPX options are used to calculate the VIX settlement value on the August VIX expiration date. Likewise, November VIX options are tied to the implied volatility of December SPX options, and so on.

One important property of implied volatility is that it exhibits a “term structure.” In other words, the implied volatility of options expiring on different dates can trade at different levels and can move independently. Another property related to the term structure is that implied volatility tends to trend toward the market’s expectation of a long-term “average” value. As a result, a large spike in one-month implied volatility might not affect implied volatility of longer-dated options very much at all.

Many market participants use volatility index (security) futures prices as proxies for forward volatility index levels. CBOE Futures Exchange, LLC (“CFE”) lists futures and security futures on all of the volatility indexes that underlie volatility index options trading on CBOE. Currently, volatility index (security) futures expirations correspond to each volatility index options expiration months listed on CBOE. Accordingly, CBOE believes that using these prices is an accurate and transparent method for determining the “current index level” for a volatility index option and whether the corresponding (security) futures prices are not available is a fact that may be considered in determining whether to halt trading in a class of volatility index options. Also, if the corresponding (security) futures prices are available, this fact weighs in favor of not halting trading in volatility index options. As such, volatility index options trading should be permitted if the corresponding volatility index (security) futures prices are available (even if spot (cash) values are not disseminated).

Importantly, the Exchange believes that volatility index options trading should not be conditioned on the concurrent dissemination of the spot (cash) value of a volatility index.

Specifically, the Exchange believes that this could be somewhat confusing as to the significance of the role that the spot (cash) value plays vis-à-vis volatility index options trading. The spot (cash) value of a volatility index is an instantaneous measure of expected volatility in 30 days. As to a specific volatility index option contract that is listed for trading, the spot (cash) value bears little relation to the value that that contract will settle to at expiration. (However, the Exchange believes that if the spot (cash) value is not being disseminated, that is a factor that may be considered in determining whether to halt trading). Therefore, the Exchange believes that it is appropriate to permit volatility index options trading even if spot (cash) values are not being disseminated.

Finally, the Exchange is proposing to make technical changes to Rule 24.7(a), Rule 24.7(d) and Rule 24.7.01 to make numbering changes.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.⁵ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁶ 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 proposed rule change will protect the integrity of the Exchange’s marketplace by permitting the Exchange to consider additional facts when determining whether to halt trading in

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).

volatility indexes options. Rule 24.7 is currently predicated on indexes being comprised of stocks and includes facts that may be considered by the Exchange when determining whether to halt trading based on the index components being stocks. The current filing amends Rule 24.7(a) to account for indexes comprised of options and allows the Exchange to consider the following facts when determining whether to halt trading: (1) whether the component options are not trading, (2) whether the “current index level” (as measured by the implied forward level based on volatility index (security) futures prices) is not available, or (3) whether the spot (cash) value for a volatility index is not available.

The Exchange believes that the proposal will lessen investor confusion because it will not condition volatility index option trading on the dissemination of the spot (cash) value of a volatility index.⁷ Because the spot (cash) value of a volatility index is an instantaneous measure of implied volatility in 30 days, that value is not a good estimate of where the market’s expectation of the prices of the options that will actually be used to calculate the settlement value for a volatility index option. The Exchange believes that a better estimate is reflected in the prices of the corresponding volatility index (security) futures. Accordingly, the Exchange believes that investor confusion would be lessened if: (1) volatility index options are permitted to trade even if the spot (cash) value is not disseminated; and (2) the Exchange is permitted to consider whether the “current index level” (as measured by the implied forward level based on volatility index (security) futures prices) or the spot (cash) value is not available in determining whether to halt trading.

⁷ The Commission notes that CBOE Rule 24.7 does not currently, by its terms, require the Exchange to halt trading in volatility index options when the current index level or the spot (cash) value for the volatility index option is not available.

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 ability to consider additional facts that are relevant to volatility index options trading when determining whether to halt trading will benefit all volatility index market participants and does not impose any burden on competition.

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. Please include File Number SR-CBOE-2013-079 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2013-079. 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-2013-079 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.⁸

Kevin M. O'Neill
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).