SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52950; File No. SR-CBOE-2004-53)

December 14, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change and Partial Amendment No. 1 Relating to Margin Requirements for Complex Options Spreads.

I. Introduction

On July 30, 2004, the Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change related to margin requirements for complex options spreads under Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")[1] and Rule 19b-4.[2] On August 23, 2005, the Exchange filed a partial amendment to its proposed rule change.[3] The proposed rule change, as amended, was published in the Federal Register on November 14, 2005.[4] The Commission received no comments on the proposal.

II. Description

The CBOE has proposed to incorporate the provisions of a Regulatory Circular (RG03-066 – Margin Requirements for Certain Complex Spreads, dated August 13, 2003) (the "Circular") into the Exchange's margin rules (Chapter 12). The Circular presents an interpretation of current margin requirements that allows the Exchange to derive, and put into effect, margin requirements for certain complex option spreads. The Commission

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

2 17 CFR 240.19b-4.

3 SR-CBOE-2004-53: Amendment No. 1. CBOE, in coordination with the New York Stock Exchange, Inc. ("NYSE"), filed the partial amendment to conform the complex options spreads strategies to which its rule amendments apply to those of the NYSE.

4 See Securities Exchange Act Release No. 52739 (Nov. 4, 2005); 70 FR 69173 (Nov. 14, 2005).

approved the Circular on a one-year pilot basis.[5] The Commission granted two extensions of the pilot period.[6]

The Exchange has proposed to add definitions of a "long condor spread," "short iron butterfly spread" and "short iron condor spread" to Rule 12.3(a). These definitions cover six of the seven strategies identified in the Circular. Each definition covers two strategies identified in the Circular because each definition provides for a base strategy, in which all options expire at the same time, and a calendar spread strategy, in which a long option may expire after the other options expire concurrently.

The Exchange has proposed a revision to its current definition of a butterfly spread to provide for the remaining strategy, a calendar spread version of the long butterfly spread. These revisions consist of (1) splitting the current butterfly spread definition into two definitions, one for the long butterfly spread and one for the short butterfly spread, (2) fashioning the two definitions so that they are consistent with the style and format of the new definitions referred to in the prior paragraph, and (3) providing for a calendar spread version in the long butterfly spread definition.

In the Circular, call options were utilized to construct three of the seven strategy examples. Each of these three strategies has a parallel application with put options. For brevity, the put option versions were not specifically identified in the Circular, but the Circular was intended to apply to the put option counterpart of each of the strategies demonstrated with call options. Both the put and call option versions are provided for in the newly proposed rule definitions. The remaining four complex spread strategies

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5 See Securities Exchange Act Release No. 48306 (Aug. 8, 2003), 68 FR 48974 (Aug. 15, 2003) (approving SR-CBOE-2003-24).

6 See Securities Exchange Act Release No. 50164 (Aug. 6, 2004), 69 FR 50405 (Aug. 16, 2004) and Securities Exchange Act Release No. 51407 (Mar. 22, 2005), 70 FR 15669 (Mar. 28, 2005).

originally identified in the Circular involved both call options and put options (that is, “iron” strategies). Each of these four strategies has a reciprocal configuration (that is, the call options can precede the put options in ascending sequence of exercise prices). However, there is no need to address the reciprocal variations because there is no benefit from a margin requirement standpoint of including them in the iron strategy definitions.

According to the Exchange, each of the complex spreads identified in the proposed rule can be derived by combining and netting two or more option spreads (that is, the butterfly spread, the box spread and the time spread) that already are identified in the margin rules and ascribed a margin requirement. Furthermore, the sum of the margin required on the basic option spreads that can be combined and netted to form a complex spread covers the maximum risk of the complex spread and, as in the Circular, is the margin requirement specified in the proposed rules. Each of the subject complex spread strategies has a known and limited risk when configured as specified in the proposed definitions. The Exchange has proposed to revise current Rule 12.3(c)(5)(C)(6) to provide a margin requirement for each of the long condor spread, short iron butterfly spread and short iron condor spread.

The Exchange noted that the proposed rule prohibits European style options in the case of the calendar version of a complex spread and requires that the interval between each option series be equal in the case of all complex spread strategies. Unlike the Circular, the proposed rules would not limit complex spreads to a margin account. The Exchange also has proposed a revision to Rule 12.3(e) – Customer Cash Account – Spreads, that adds the long condor spread, short iron butterfly spread and short iron condor spread as strategies permitted to be established and carried in a cash account, provided they are composed of cash-settled, European style options that all expire at the same time.

The Exchange noted that it has received no negative comments concerning the Circular since it was issued. Moreover, the Exchange is not aware of any negative consequences as a result of applying the margin requirements permitted by the Circular.

III. Discussion and Commission Findings

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.[7] In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,[8] which requires that the rules of the exchange be designed, among other things, to remove impediments to and perfect the mechanisms of a free and open market, and, in general, to protect investors and the public interest. The Commission finds that amending the rules to permit complex option spread strategies that are the net result of combining two or more spread strategies that are currently recognized in the Exchange's margin rules is consistent with the requirements of Section 6(b)(5) because the amendments will allow the Exchange to set levels of margin that more precisely represent the actual net risk of the option positions in the account and enable customers to implement these strategies more efficiently.

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

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

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[9] that the proposed rule change (File No. SR-CBOE-2004-53), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Jonathan G. Katz
Secretary

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[9] 15 U.S.C. 78s(b)(2).

[10] 17 CFR 200.30-3(a)(12).