

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59876; File No. SR-CBOE-2008-55)

May 6, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 1, Related to Margin Requirements

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 2, 2008, the Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission” or “SEC”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. On May 3, 2009, CBOE filed Amendment No. 1. The Commission is publishing this notice, as amended, 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

The Exchange proposes to modify its margin requirements to facilitate, under certain circumstances, the ability of account holders to use vested and currently exercisable compensatory employee stock options (“Vested Employee Options”) issued by publicly traded companies as collateral for writing call options that have the same underlying security as the Vested Employee Options. Specifically, the proposal would allow account holders to sell, as a hedge, listed equity call options on the same underlying security as the account holder’s Vested Employee Options without the requirement of margin. 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.

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 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 proposes to amend its margin requirements to facilitate, under certain circumstances, the ability of account holders to use Vested Employee Options issued by publicly traded companies (“Issuers”) as collateral for writing call options that have the same underlying security as the Vested Employee Options. Specifically, the proposal would allow account holders to sell, as a hedge, listed equity call options on the same underlying security as the account holder’s Vested Employee Options without the requirement of margin (the “Transactions”).³ The proposal would permit account holders to engage in the Transactions using their Vested Employee Options as collateral. Currently, such Transactions would be deemed “naked” for purposes of margin rules and subject to a deposit of cash margin, effectively making the strategies cost prohibitive and impractical. The Exchange believes that enabling employees who hold Vested Employee Options to generate income and liquidity on their otherwise illiquid asset through the listed options markets will benefit investors by providing greater transparency and liquidity.

³ Absent relief from the Securities and Exchange Commission, broker-dealers would need to take a capital charge for the amount of unsecured margin debt.

Under Section 220.12(f)(1) of Regulation T,⁴ the Exchange, as a registered national securities exchange, is permitted to recognize the type of transactions described below as eligible for margin treatment subject to the approval of the Commission.

There appears to be precedent to create liquidity for holders of Vested Employee Options, as indicated by initiatives by Google Inc. (“Google”) and Credit Suisse First Boston (“CSFB”). Specifically, in the second quarter of 2007, Google implemented a program that enables certain employees to sell their Vested Employee Options to financial institutions that bid their Vested Employee Options through a competitive auction.⁵ Additionally, in March 2004, the SEC’s Division of Corporation Finance provided CSFB a no-action letter (the “CSFB No-Action Letter”)⁶ with respect to CSFB’s plan to enable persons subject to Section 16 of the Securities Exchange Act of 1934 (the “Act”), e.g., directors, officers and 10-percent shareholders (“Section 16 insiders”), with substantially in-the-money vested employee stock options to use over-the-counter derivatives to limit their exposure to fluctuations in the trading price of the underlying common stock. Under CSFB’s program, Section 16 insiders sell CSFB a call option and buy from CSFB a put option on common stock underlying their stock options. The exercise prices of the call and put options (together, a “collar”) are determined so as to provide the Section 16 insiders a measure of protection against a fall in the market value of the common stock during the collar’s term in return for diminishing the

⁴ Section 220.12(f)(1) of Regulation T (12 CFR 220), Supplement: Margin Requirements, grants authority to registered national securities exchanges to promulgate rules relating to call and put margin requirements.

⁵ See http://www.google.com/intl/en/press/pressrel/ir_20061212.html.

⁶ Credit Suisse First Boston, SEC No-Action Letter, 2004 WSB 0712200401 (March 18, 2004).

ability of the Section 16 insiders to profit from a strong performance for the common stock during such period.

Unlike Google's program, which will generally truncate the remaining term of Google Vested Employee Options to two years upon their sale (resulting in holders forfeiting any time value of their Vested Employee Options beyond the two-year period), CBOE's proposal would allow holders of Vested Employee Options to monetize the entire remaining time value of their Vested Employee Options because the term of the Vested Employee Options would be unaffected by the listed call option.

Unlike CSFB's program, CBOE's proposal would make it possible for not only Section 16 insiders (who would generally be able to meet existing listed option margin deposit requirements) but also "paper rich/cash poor" holders to monetize the value of their Vested Employee Options. Also, unlike CSFB's program, the proposal would permit account holders to sell call options against their Vested Employee Options in the listed options markets, which generally provide more liquidity and transparency than the over-the-counter markets.

Description of the Transactions

The proposal would permit account holders to sell listed call options on the same security that underlies their Vested Employee Options without the requirement of margin. Given the uncertificated nature of employee stock options, in order to secure the account holder's obligations under the Transactions, the proposal would require:

1. The account holder to (A) pledge the Vested Employee Options to the broker-dealer and (B) provide the broker-dealer with an irrevocable power-of-attorney authorizing the broker-dealer to exercise the Vested Employee Options on the account holder's behalf if

the listed call options are assigned or if the broker-dealer determines it is necessary. The irrevocable power-of-attorney may also be used in the event the account holder wishes to close the listed option position prior to its expiration and instructs the broker-dealer to exercise that number of Vested Employee Options necessary to cover the cost of the closing purchase (the account holder will also have the option of depositing additional cash in the account holder's account to cover the cost of the closing purchase).

2. In the event the Vested Employee Options are exercised between the date of the Transaction in the listed call options (the "Commencement Date") and the date the Transaction is closed (the "Closing Date"), the shares issued upon exercise will be pledged to the broker-dealer (thereby replacing the Vested Employee Options that had been pledged prior to exercise). For example, during the time a Transaction is pending, the account holder may resign from the account holder's employment with the Issuer and may be required to exercise the Vested Employee Options within a certain timeframe following the account holder's departure. In such a scenario, the account holder would ask the broker dealer to exercise the Vested Employee Options and the stock issued pursuant to the exercise would be pledged to the broker-dealer.

3. The Issuer will promptly deliver the stock upon payment or receipt of the exercise notice from the broker-dealer.⁷ The Issuer will also agree prior to the Commencement Date to waive any forfeiture conditions that otherwise might apply to the Vested Employee Options (e.g., upon a termination of the account holder's employment with the Issuer) as well as any transfer restrictions that would preclude pledge of the Vested Employee Options to the broker-dealer. In addition, the Issuer will represent that the Vested

⁷ The Exchange will proscribe a set delivery period, which is expected to be no later than three business days following assignment of the listed options.

Employee Options are covered by an effective registration statement on Form S-8. If the registration statement becomes ineffective the Issuer will notify the broker-dealer immediately.

4. Because it is essential that the account holder, broker-dealer and Issuer cooperate and are each fully informed, agree to and acknowledge their own and each other's responsibilities, all Transactions will be governed by an agreement (the "Agreement") entered into by the account holder, broker-dealer and Issuer prior to the Commencement Date of the first transaction. The Agreement would generally set forth each party's obligations, representations and acknowledgements and the terms and conditions governing the Transactions and must be in a form acceptable to the Exchange.⁸

5. Such other terms and conditions prescribed by the Exchange in accordance with such form, formats and procedures as may be established by the Exchange from time to time would also apply. In this regard, upon approval of the proposed rule change and for a period of one year, the Exchange will require that, prior to the Commencement Date, a legal opinion with respect to the account holder's and Issuer's legal right to enter into the Transactions under the terms of the Issuer's employee stock option plan and related documents (the "Legal Opinion") be obtained in a form acceptable to the Exchange. During the one-year time period, the Exchange may determine that such Legal Opinion is no longer necessary and will revise its established forms, formats and procedures accordingly.

⁸ In this regard, the Exchange currently intends to recognize the Master Vested Stock Option Monetization Agreement, created by iOptions Group, LLC, as one acceptable agreement.

2. Statutory Basis

The basis under the Act for this proposed rule change is found in Section 6(b)(5),⁹ in that the proposed rule change is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest. By recognizing that margin should not be required for customers for the transactions contemplated by this proposed rule change, both investors and the listed equity options markets will benefit as a result of greater transparency and liquidity.

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.

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 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be

⁹ 15 U.S.C. 78f(b)(5).

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. Specifically the Commission requests comment on the following topics:

- Are there other alternative steps that could be taken that would enhance a broker-dealer's legal authority to exercise the Vested Employee Options and receive the underlying stock? Please describe any such alternatives and why those alternatives may be more consistent with the Act.
- If no margin is required for a Transaction, what steps, if any, should be taken regarding liquidity or operational risks arising from the Transactions? Should the margin rule include a minimum margin requirement?

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-2008-55 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-2008-55. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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-2008-55 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.¹⁰

Florence E. Harmon
Deputy Secretary

¹⁰ 17 CFR 200.30-3(a)(12).