

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62911; File No. SR-CBOE-2009-075)

September 14, 2010

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Notice of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, to Establish a Pilot Program to List P.M.-Settled End of Week and End of Month Expirations for Options on Broad-Based Indexes

On October 14, 2009, 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 (“Act”),¹ a proposed rule change to establish a pilot program that would permit p.m.-settled options on broad-based indexes expiring on any Friday of the month, other than the third Friday of the month, as well as the last trading day of the month. On May 3, 2010, the Exchange filed Amendment 1 to the proposed rule change, and on July 30, 2010, the Exchange filed Amendment 2 to the proposed rule change.² The proposed rule change was published for comment in the Federal Register on August 12, 2010.³ The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change

The Exchange is proposing to establish a pilot program that would permit p.m.-settled options on broad-based indexes to expire on (a) any Friday of the month, other than the third Friday of the month⁴ (“End of Week Expirations” or “EOWs”), and (b) the last trading day of the

¹ 15 U.S.C. 78s(b)(1).

² Amendment 2 replaced Amendment 1 and the original filing in their entireties. The purpose of Amendment 2 is to broaden the definition of End of Week Expirations to include any Friday of the month, other than the third Friday of the month.

³ See Securities Exchange Act Release No. 62658 (August 5, 2010), 75 FR 49009 (“Notice”).

⁴ A third Friday of the month expiration is generally referred to as “Expiration Friday.”

month (“End of Month Expirations” or “EOMs”).⁵ Under the End of Week/End of Month Expirations Pilot Program (“Pilot”), EOWs and EOMs will be permitted on any broad-based index that is eligible for regular options trading. EOWs and EOMs will be cash-settled and have European-style exercise, and will be subject to the same rules that currently govern the trading of traditional index options, including sales practice rules, margin requirements, and floor trading procedures. Contract terms for EOWs and EOMs will be similar to regular index options, except the exercise settlement value will be based on the index value derived from the closing prices of component stocks. EOWs and EOMs on the same broad-based index (e.g., of the same class) shall be aggregated for position limits (if any) and any applicable reporting and other requirements.⁶ The duration of the Pilot will be effective for a period of fourteen months from the next full month from approval.⁷

Currently, the vast majority of options in the standardized options markets are a.m.-settled.⁸ In light of historic Commission concerns about expanding p.m. settlement, CBOE has

⁵ For example, if EOWs and EOMs were currently listed, the expiration dates for October 2010 would be: October 1 (EOW), October 8 (EOW), October 15 (standard), October 22 (EOW) and October 29 (EOM). If the last trading day of the month is a Friday, the Exchange will list an End of Month expiration series and not an End of Week expiration. See Rule 24.9(a)(2) for specific rule governing the expiration months that may be listed for index options. CBOE does not intend to list EOWs or EOMs that would expire on Exchange holidays.

⁶ See e.g., CBOE Rule 4.13, Reports Related to Position Limits and Interpretation and Policy .03 to Rule 24.4 which sets forth the reporting requirements for certain broad-based indexes that do not have position limits.

⁷ Any positions established under the Pilot would not be impacted by the expiration of the Pilot. If an EOW or EOM expiration expires after the Pilot expires, then those positions would continue to exist; however, any further trading in those series would be restricted to transactions where at least one side of the trade is a closing transaction. The Exchange would address this point in a circular to members. See Notice, supra note 3, 75 FR 49011.

⁸ In the 1980s, the options and futures markets began moving from closing-price to opening price settlement procedures for stock index options and futures as a result of

represented that, at least two months prior to the expiration of the Pilot, it will provide the Commission with an annual report analyzing EOW and EOM volume, open interest, and trading patterns.⁹ In addition, for series that exceed specific minimum open interest parameters, the annual report will provide an analysis of index price volatility and, if needed, underlying share trading volume.¹⁰ The annual report will be provided to the Commission on a confidential basis.¹¹

The Commission has carefully reviewed CBOE's proposed rule change and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,¹² and, in particular, Section 6(b)(5) of the Act,¹³ which requires that an exchange have rules designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest, to allow CBOE to conduct limited, and carefully monitored, pilots as proposed.

increased market and price volatility in underlying component stocks due to the unwinding of arbitrage-related positions at the close on expiration Friday.

⁹ The annual report would also contain information and analyses of standard Expiration Friday, a.m.-settled series, if applicable, for the period covered in the pilot report as well as for the six-month period prior to the initiation of the pilot. See Notice, supra note 3, 75 FR at 49011.

¹⁰ For each EOW and EOM Expiration that has open interest that exceeds certain minimum thresholds, the annual report will contain a comparison of index price changes at the close of trading on a given expiration date with comparable price changes from a control sample; and if needed, a calculation of share volume for a sample set of the component securities representing an upper limit on share trading that could be attributable to expiring in-the-money EOW and EOM expirations.

¹¹ CBOE will also provide to the Commission upon request a data file containing (1) EOW and EOM option volume data aggregated by series, and (2) EOW week-ending open interest for expiring series and EOM month-end open interest for expiring series.

¹² 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).

¹³ 15 U.S.C. 78f(b)(5).

The Commission has had concerns about the adverse effects and impact of p.m. settlement upon market volatility and the operation of fair and orderly markets on the underlying cash market at or near the close of trading. Only in limited instances has the Commission previously approved p.m. settlement for cash-settled options. In 1993, the Commission approved CBOE's listing of p.m.-settled, cash-settled options on certain broad-based indexes expiring on the first business day of the month following the end of each calendar quarter ("Quarterly Index Expirations").¹⁴ In 2006, the Commission approved, on a pilot basis, CBOE's listing of p.m.-settled index options expiring on the last business day of a calendar quarter ("Quarterly Options Series").¹⁵ In 2010, the Commission approved CBOE's listing of p.m.-settled FLEX options on a pilot basis.¹⁶

The Commission believes that it is appropriate to approve the proposal on a pilot basis. CBOE's proposed fourteen month Pilot will allow for both the Exchange and the Commission to monitor the potential for adverse market effects. In particular, the Commission notes that CBOE will provide the Commission with the annual report analyzing volume and open interest of EOWs and EOMs, will also contain information and analysis of EOW and EOM trading patterns, and index price volatility and share trading activity for series that exceed minimum parameters. This information will enable the Commission to evaluate whether allowing p.m. settlement for EOW and EOMs will result in increased market and price volatility in the underlying component

¹⁴ See Securities Exchange Act Release No. 31800 (February 1, 1993), 58 FR 7274 (February 5, 1993).

¹⁵ See Securities Exchange Act Release No. 54123 (July 11, 2006), 71 FR 40558 (July 17, 2006).

¹⁶ See Securities Exchange Act Release No. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010) (SR-CBOE-2009-087) (order approving rule change to establish a pilot program to modify FLEX option exercise settlement values and minimum value sizes).

stocks.

The p.m. settlement Pilot information should help the Commission assess the impact on the markets and determine whether other changes are necessary. Furthermore, the Exchange's ongoing analysis of the Pilot should help it monitor any potential risks from large p.m.-settled positions and take appropriate action if warranted.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁷ that the proposed rule change (SR-CBOE-2009-075), as modified by Amendment Nos. 1 and 2, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁸

Florence E. Harmon
Deputy Secretary

¹⁷ 15 U.S.C. 78s(b)(2).

¹⁸ 17 CFR 200.30-3(a)(12).