

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-63546; File No. SR-CBOE-2010-106)

December 15, 2010

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 1, 2010, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II, below, which Items have been substantially prepared by the Exchange. On December 14, 2010, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> 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 Rule 12.3(1), Margin Requirements, to make CBOE’s margin requirements for Credit Options consistent with Financial Industry Regulatory Authority (“FINRA”) Rule 4240, Margin Requirements for Credit Default Swaps. CBOE’s Credit Options (i.e., Credit Default Options and Credit Default Basket Options) are analogous to credit default

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 to SR-CBOE-2010-106 replaced and superseded the original rule filing in its entirety.

swaps.<sup>4</sup> The text of the rule proposal is available on the Exchange’s website

(<http://www.cboe.org/legal>), at the Exchange’s Office of the Secretary and at the Commission.

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

This filing proposes to amend Rule 12.3(1), Margin Requirements, to make CBOE’s margin requirements for Credit Options consistent with FINRA Rule 4240, Margin Requirements for Credit Default Swaps. CBOE’s Credit Options consist of two variations – Credit Default Options and Credit Default Basket Options. Credit Default Options and Credit Default Basket Options are also referred to as “Credit Event Binary Options.” Effectively, both contracts operate in the same manner as credit default swap contracts.

Amendment No. 1 replaces the original filing in its entirety. The purpose of Amendment No. 1 is to restyle the original proposal on a pilot basis.

As with a credit default swap contract, the buyer of a Credit Option contract is buying protection from the seller of the Credit Option. This protection is in the form of a monetary payment from the Credit Option seller to the Credit Option buyer in the event that the issuer of

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<sup>4</sup> CBOE’s Credit Default Options and Credit Default Basket Options are also referred to as Credit Event Binary Options.

debt securities, or Reference Entity, specified as underlying the Credit Option contract has a Credit Event (e.g., declares bankruptcy), consequently defaulting on the payment of principal and interest on its debt securities. When a Credit Option buyer and seller initially open their positions via a transaction consummated on the Exchange, the Credit Option buyer's account is charged (debited) for the cost of the protection. The Credit Option seller's account is credited. For the protection, there is only a one-time debit and credit to the buyer and seller, respectively. If, prior to expiration of the Credit Option, a Credit Event occurs (e.g., bankruptcy is declared), the Credit Option contract is settled with a credit to the Credit Option buyer's account for a predetermined payout amount (e.g., \$1,000), based on the Exchange's contract specifications. The Credit Option seller's account is debited (charged) for the payout amount.

Credit Default Options have a single Reference Entity. Credit Default Basket Options have multiple Reference Entities. If a Credit Default Basket Option is specified as having a single payout, settlement is triggered when any one of the component Reference Entities has a Credit Event (e.g., declares bankruptcy) and thereafter the option ceases to exist. The payout is the settlement amount attached to that one Reference Entity. If a Credit Default Basket Option is specified as having multiple payouts, a settlement is triggered when any one of the component Reference Entities has a Credit Event (e.g., declares bankruptcy), but the option continues to exist until its expiration. Therefore, additional settlements would be triggered if, and as, any Credit Events occur in respect of the remaining Reference Entity components. The payout is the settlement amount attached to each particular Reference Entity.

The current Exchange margin requirements for Credit Options were established before FINRA implemented margin requirements for credit default swaps (FINRA Rule 4240). In order to be consistent with FINRA margin requirements and establish a level playing field for similar

instruments, CBOE's proposed amendments adopt the FINRA requirements to a large extent. For Credit Default Options, which overlie a single Reference Entity, CBOE proposes to adopt FINRA's margin percentage table for credit default swaps. With respect to Credit Default Basket Options, CBOE is adopting the margin percentage table that FINRA requires for CDX indices because, like an index, a Credit Default Basket Option involves multiple component Reference Entities. CBOE proposes to revise the FINRA column headings to fit Credit Options. FINRA Rule 4240 requires the percentage to be applied to the notional amount of a credit default swap. CBOE's proposed rules would require that the percentage be applied to the settlement value of a Credit Option to arrive at a margin requirement because the settlement value of a Credit Option is analogous to the notional amount of a credit default swap. CBOE's proposed rules incorporate all other relevant aspects of FINRA 4240, such as risk monitoring procedures and guidelines, and concentration charge (net capital) requirements.

It should be noted that CBOE's proposed rules would require no margin in the case of a spread (i.e., long and short Credit Options with the same underlying Reference Entity or Entities.) This differs from FINRA Rule 4240, which requires margin of 50% of the margin required on the long or short (credit default swap), whichever is greater. CBOE is proposing no margin because the long and short are required to have the same underlying Reference Entity. Moreover, Credit Options are standardized and are settled through The Options Clearing Corp.

CBOE's proposed rules would also require no margin on a short Credit Default Option that is offset with a short position in a debt security issued by the Reference Entity underlying the option. This language differs from the debt security offset allowed under FINRA Rule 4240. However, applicable margin must still be collected on the short position in a debt security as prescribed pursuant to applicable margin rules. Rule 4240 requires no margin for a long credit

default swap contract that is paired with a long position in the underlying debt security. However, this type of offset does not appear to be workable in respect of a Credit Default Option.

The proposal will become effective on a pilot basis to run a parallel track with FINRA Rule 4240 that operates on an interim pilot basis which is currently scheduled to expire on July 16, 2011.<sup>5</sup> If the Exchange were to propose an extension of the Credit Option Margin Pilot Program or should the Exchange propose to make the Pilot Program permanent, then the Exchange would submit a filing proposing such amendments to the Pilot Program.

## 2. Statutory Basis

The Exchange believes this rule proposal is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>6</sup> Specifically, the Exchange believes that the proposed rule change is consistent with the Section 6(b)(5) Act<sup>7</sup> requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest, and because it enhances fair competition among exchange markets.

### 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.

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<sup>5</sup> See Securities Exchange Act Release No. 63391 (November 30, 2010), 75 FR 75718 (December 6, 2010) (notice of filing for immediate effectiveness extending FINRA Rule 4240 margin interim pilot program to July 16, 2011).

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

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 (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 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, as amended, 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2010-106 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-2010-106. 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 Exchange. 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-2010-106 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.<sup>8</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).