

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64722; File No. SR-CBOE-2011-055)

June 22, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change to Trade Options on the CBOE Silver ETF Volatility Index

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 June 15, 2011, 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 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

Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) proposes to amend certain of its rules to provide for the listing and trading of options that overlie the CBOE Silver ETF Volatility Index (“VXSLV”), which will be cash-settled and will have European-style exercise. 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

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

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

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

The purpose of this proposed rule change is to permit the Exchange to list and trade cash-settled, European-style options on the CBOE Silver ETF Volatility Index (“VXSLV”).

The Exchange has previously received approval orders to trade options on other volatility indexes that are calculated using certain individual stock and exchange-traded fund (“ETF”) options listed on CBOE.<sup>3</sup> In the most recent approval order, the Exchange genericized certain of its rules to collectively refer to these indexes as “Individual Stock Based Volatility Indexes,” “ETF Based Volatility Indexes,” and “Volatility Indexes,” as applicable.<sup>4</sup> The specific Individual Stock Based Volatility Indexes and ETF Based Volatility Indexes that have been approved for options trading are listed in Rule 24.1(bb). This filing layers VXSLV into CBOE's existing rule framework for “ETF Based Volatility Indexes” and “Volatility Indexes,” since VXSLV is comprised of ETF options.

Index Design and Calculation

The calculation of VXSLV is based on the VIX methodology applied to options on the iShares Silver Trust (“SLV”). The VXSLV index was introduced by CBOE on March 16, 2011

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<sup>3</sup> See Securities Exchange Act Release Nos. 62139 (May 19, 2010) 75 FR 29597 (May 26, 2010) (order approving proposal to list and trade CBOE Gold ETF Volatility Index (“GVZ”) options on CBOE) and 64551 (May 26, 2011), 76 FR 32000 (June 2, 2011) (order approving proposal to list and trade options on certain individual stock based volatility indexes and ETF based volatility indexes).

<sup>4</sup> See Rules 12.3, 24.1(bb), 24.4C, 24.5.04, 24.6, 24.9, 24A.7, 24A.8, 24B.7 and 24B.8.

and has been disseminated in real-time on every trading day since that time.<sup>5</sup>

VXSLV is an up-to-the-minute market estimate of the expected volatility of SLV calculated by using real-time bid/ask quotes of CBOE listed SLV options. VXSLV uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected (implied) volatility.

For each contract month, CBOE will determine the at-the-money strike price. The Exchange will then select the at-the-money and out-of-the money series with non-zero bid prices and determine the midpoint of the bid-ask quote for each of these series. The midpoint quote of each series is then weighted so that the further away that series is from the at-the-money strike, the less weight that is accorded to the quote. Then, to compute the index level, CBOE will calculate a volatility measure for the nearby options and then for the second nearby options. This is done using the weighted mid-point of the prevailing bid-ask quotes for all included option series with the same expiration date. These volatility measures are then interpolated to arrive at a single, constant 30-day measure of volatility.<sup>6</sup>

CBOE will compute values for VXSLV underlying option series on a real-time basis throughout each trading day, from 8:30 a.m. until 3:00 p.m. (CT).<sup>7</sup> VXSLV levels will be calculated by CBOE and disseminated at 15-second intervals to major market data vendors.

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<sup>5</sup> CBOE maintains a micro-site for VXSLV:  
<http://www.cboe.com/micro/VIXETF/VXSLV/>.

<sup>6</sup> See proposed amendment to Interpretation and Policy .01 to Rule 24.1 (designating CBOE as the reporting authority for VXSLV).

<sup>7</sup> Trading in SLV options (the index components of VXSLV) on CBOE closes at 3:00 p.m. (Chicago time). See Rule 24.6.02. The Exchange is proposing to make non-substantive changes to this rule.

## Options Trading

VXSLV options will trade pursuant to the existing trading rules for other Volatility Index options. VXSLV options will be quoted in index points and fractions and one point will equal \$100. The minimum tick size for series trading below \$3 will be 0.05 (\$5.00) and above \$3 will be 0.10 (\$10.00). Initially, the Exchange will list in-, at- and out-of-the-money strike prices and the procedures for adding additional series are provided in Rule 5.5.<sup>8</sup> Dollar strikes (or greater) will be permitted for VXSLV options where the strike price is \$200 or less and \$5 or greater where the strike price is greater than \$200. The Exchange will not be permitted to list LEAPS on VXSLV options at strike price intervals less than \$1.<sup>9</sup>

Transactions in VXSLV may be effected on the Exchange between the hours of 8:30 a.m. Chicago time and 3:00 p.m. (Chicago time). The Exchange is proposing to close trading at 3:00

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<sup>8</sup> See Rule 5.5(c). “Additional series of options of the same class may be opened for trading on the Exchange when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying... moves substantially from the initial exercise price or prices.” For purposes of this rule, “market price” shall mean the implied forward level based on any corresponding futures price or the calculated forward value of VXSLV.

<sup>9</sup> See Rule 24.9.01(l). The Exchange is proposing to amend Rule 24.9.01(l) by expressly providing that “[t]he Exchange shall not list LEAPS on Volatility Index options at strike price intervals less than \$1.” The Exchange notes that when GVZ options were approved for trading, a substantially similar provision regarding the strike price intervals for LEAPS was adopted. See Securities Exchange Act Release No. 62139 (May 19, 2010) 75 FR 29597 (May 26, 2010). However, when the Exchange filed to list options on certain individual stock based volatility indexes and ETF based volatility indexes, the Exchange revised the strike setting parameters for Volatility Index options to permit \$1 strikes where the strike price is \$200 or less. The LEAPS strike setting provision was inadvertently not carried forward at the time Rule 24.9.01(l) was adopted, but should have been.

p.m. (Chicago time) for VXSLV options because trading in SLV options on CBOE closes at 3:00 p.m. (Chicago time).<sup>10</sup>

### Exercise and Settlement

The proposed options will typically expire on the Wednesday that is 30 days prior to the third Friday of the calendar month immediately following the expiration month (the expiration date of the options used in the calculation of the index). If the third Friday of the calendar month immediately following the expiring month is a CBOE holiday, the expiration date will be 30 days prior to the CBOE business day immediately preceding that Friday.<sup>11</sup> For example, November 2011 Vol VXSLV options would expire on Wednesday, November 16, 2011, exactly 30 days prior to the third Friday of the calendar month immediately following the expiring month.

Trading in the expiring contract month will normally cease at 3:00 pm (Chicago time) on the business day immediately preceding the expiration date. Exercise will result in delivery of cash on the business day following expiration. VXSLV options will be A.M.-settled.<sup>12</sup> The exercise settlement value will be determined by a Special Opening Quotations (“SOQ”) of VXSLV calculated from the sequence of opening prices of a single strip of options expiring 30 days after the settlement date. The opening price for any series in which there is no trade shall be the average of that options’ bid price and ask price as determined at the opening of trading.<sup>13</sup>

The exercise-settlement amount will be equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by \$100. When the last trading

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<sup>10</sup> See Rule 24.6.02.

<sup>11</sup> See Rule 24.9(a)(5).

<sup>12</sup> See proposed amendment to Rule 24.9(a)(4) (adding VXSLV to the list of A.M.-settled index options approved for trading on the Exchange).

<sup>13</sup> See Rule 24.9(a)(5).

day is moved because of a CBOE holiday, the last trading day for expiring options will be the day immediately preceding the last regularly-scheduled trading day.

#### Position and Exercise Limits

The Exchange is proposing that the existing position limits for ETF Based Volatility Index options apply to VXSLV options.<sup>14</sup> For regular options trading, the position limit for VXSLV options will be 50,000 contracts on either side of the market and no more than 30,000 contracts in the nearest expiration month. CBOE believes that a 50,000 contract position limit is appropriate due to the fact that SLV options, which are the underlying components for VXSLV, are among the most actively traded option classes currently listed. In determining compliance with these proposed position limits, VXSLV options will not be aggregated with the SLV options.<sup>15</sup> Positions in Short Term Option Series, Quarterly Options Series, and Delayed Start Option Series will be aggregated with position in options contracts in the same VXSLV class.<sup>16</sup>

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<sup>14</sup> See Rule 24.4C (Position Limits for Individual Stock or ETF Based Volatility Index Options).

<sup>15</sup> See Rule 24.4C(b).

<sup>16</sup> See proposed new subparagraph (c) to Rule 24.4C. The Exchange is proposing to add new subparagraph (c) regarding aggregation to Rule 24.4C. The Exchange notes that when GVZ options were approved for trading, the position limits for GVZ options were layered into existing Rule 24.4 (Position Limits for Broad-Based Index Options). Rule 24.4(e) sets forth an aggregation requirement substantially similar to proposed new subparagraph (c) to Rule 24.4C. See Securities Exchange Act Release No. 62139 (May 19, 2010) 75 FR 29597 (May 26, 2010). When the Exchange filed to list options on certain individual stock based volatility indexes and ETF based volatility indexes, the Exchange removed GVZ from Rule 24.4 and proposed a new rule setting forth positions limits for these products. The aggregation requirement from Rule 24.4(e) was inadvertently not carried forward at the time Rule 24.4C was adopted, but should have been.

Exercise limits will be equivalent to the proposed position limits.<sup>17</sup> VXSLV options will be subject to the same reporting requirements triggered for other options dealt in on the Exchange.

The Exchange is proposing that the existing position limits for FLEX ETF Based Volatility Index options apply to VXSLV options. Specifically, the position limits for FLEX VXSLV Options will be equal to the position limits for Non-FLEX VXSLV Options.<sup>18</sup> Similarly, the exercise limits for FLEX VXSLV Options will be equivalent to the position limits set forth in Rule 24.4C. As provided for in Rules 24A.7(d) and 24B.7(d), as long as the options positions remain open, positions in FLEX VXSLV Options that expire on the same day as Non-FLEX VXSLV Index Options, as determined pursuant to Rule 24.9(a)(5), shall be aggregated with positions in Non-FLEX VXSLV Options and shall be subject to the position limits set forth in Rules 4.11, 24.4, 24.4A, 24.4B and 24.4C, and the exercise limits set forth in Rules 4.12 and 24.5.

The Exchange is proposing that the existing Hedge Exemption for ETF Based Volatility Index options apply to VXSLV options, which would be in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. The following procedures and criteria must be satisfied to qualify for a ETF Based Volatility Index hedge exemption:

- The account in which the exempt option positions are held (“hedge exemption account”) has received prior Exchange approval for the hedge exemption specifying the maximum number of contracts which may be exempt. The hedge exemption account has provided all information required on Exchange-approved forms and has kept such information

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<sup>17</sup> See Rule 24.5.

<sup>18</sup> See Rules 24A.7(a)(5) and 24B.7(a)(5).

current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two (2) business days or such other time period designated by the Department of Market Regulation furnish the Department of Market Regulation with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

- A hedge exemption account that is not carried by a CBOE member organization must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.
- The hedge exemption account maintains a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of a net long or short position in ETF Based Volatility Index futures contracts or in options on ETF Based Volatility Index futures contracts, or long or short positions in ETF Based Volatility Index options, for which the underlying ETF Based Volatility Index is included in the same margin or cross-margin product group cleared at the Clearing Corporation as the ETF Based Volatility Index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.
- The exemption applies to positions in ETF Based Volatility Index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The unhedged value will be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess

of the standard limit, the underlying market value (a) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (b) of any opposite side of the market positions in ETF Based Volatility Index futures, options on ETF Based Volatility Index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows—the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

- Only the following qualified hedging transactions and positions will be eligible for purposes of hedging a qualified portfolio (i.e. futures and options) pursuant to Interpretation .01 to Rule 24.4C:
  - Long put(s) used to hedge the holdings of a qualified portfolio;
  - Long call(s) used to hedge a short position in a qualified portfolio;
  - Short call(s) used to hedge the holdings of a qualified portfolio; and
  - Short put(s) used to hedge a short position in a qualified portfolio.
- The following strategies may be effected only in conjunction with a qualified stock portfolio:
  - A short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (a “collar”). Neither side of the collar transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rule 4.11 and Rule 24.4C, a collar position will be

treated as one (1) contract;

- A long put position coupled with a short put position overlying the same ETF Based Volatility Index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s) (a “debit put spread position”); and
- A short call position accompanied by a debit put spread position, where the short call(s) expires with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Neither side of the short call, long put transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rule 4.11 and Rule 24.4C, the short call and long put positions will be treated as one (1) contract.
- The hedge exemption account shall:
  - liquidate and establish options, their equivalent or other qualified portfolio products in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes.
  - liquidate any options prior to or contemporaneously with a decrease in the hedged value of the qualified portfolio which options would thereby be rendered excessive.
  - promptly notify the Exchange of any material change in the qualified portfolio which materially affects the unhedged value of the qualified portfolio.
- If an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted.

### Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX, XXIV, XXIVA, and XXIVB will equally apply to VXSLV options.

The Exchange is proposing that the margin requirements for VXSLV options be set at the same levels that apply to ETF Based Volatility Index options under Exchange Rule 12.3. Margin of up to 100% of the current market value of the option, plus 20% of the underlying volatility index value must be deposited and maintained. Additional margin may be required pursuant to Exchange Rule 12.10.

As with other ETF Based Volatility Index options, the Exchange hereby designates VXSLV options as eligible for trading as Flexible Exchange Options as provided for in Chapters XXIVA (Flexible Exchange Options) and XXIVB (FLEX Hybrid Trading System). The Exchange notes that FLEX VXSLV Options will only expire on business days that non-FLEX VXSLV options expire. This is because the term “exercise settlement value” in Rules 24A.4(b)(3) and 24B.4(b)(3), *Special Terms for FLEX Index Options*, has the same meaning set forth in Rule 24.9(a)(5). As is described earlier, Rule 24.9(a)(5) provides that the exercise settlement value of VXSLV options for all purposes under CBOE Rules will be calculated as the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which a VXSLV option expires.

### Capacity

CBOE has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority have the necessary systems capacity to handle the additional traffic associated with the listing of new series that would result from the introduction of VXSLV options.

## Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the Exchange's other Volatility Index and index options to monitor trading in VXSLV options. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in VXSLV options. For surveillance purposes, the Exchange will have complete access to information regarding trading activity in the pertinent underlying securities.

### 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b)<sup>19</sup> of the Securities Exchange Act of 1934 (the "Act"), in general, and furthers the objectives of Section 6(b)(5)<sup>20</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanisms of a free and open market in a manner consistent with the protection of investors and the public interest. The Exchange believes that the introduction of VXSLV options will attract order flow to the Exchange, increase the variety of listed options to investors, and provide a valuable hedging tool to investors.

#### 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>19</sup> 15 U.S.C. 78f(b).

<sup>20</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 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 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 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-2011-055 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-2011-055. 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 the 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-2011-055 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>21</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>21</sup> 17 CFR 200.30-3(a)(12).