

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-71458; File No. SR-CBOE-2014-003)

January 31, 2014

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change to List and Trade CBOE Short-Term Volatility Index Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 27, 2014, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. 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 certain of its rules to provide for the listing and trading of options that overlie the CBOE Short-Term Volatility Index (“VXST”). VXST options would be cash-settled contracts with European-style exercise that expire every week. The text of the proposed rule change is available on the Exchange’s Web site <http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

The purpose of this proposed rule change is to permit the Exchange to list and trade options that overlie the CBOE Short-Term Volatility Index (“VXST”). VXST options would be cash-settled contracts with European-style exercise that expire every week.

The Exchange created the VXST index in response to market demand for an option contract on a short-term volatility index that expires each week. The VXST index is designed to measure investors’ consensus view of future (nine day) expected stock market volatility. The proposed new VXST options would trade alongside existing CBOE Volatility Index (“VIX”) options (which expire on a monthly basis and measure a 30 day period of implied volatility) and on one Wednesday each month, the Exchange plans to calculate two exercise settlement values based on different S&P 500 index options (one expiring in 30 days and one expiring in nine days) to settle expiring VIX and VXST options.³

Index Design and Calculation

The calculation of VXST is based on the VIX methodology applied to option series on the S&P 500 index that expire on every Friday, including standard S&P 500 index option series (i.e., third Friday expirations).⁴ Similar to VIX and VIX options, the cash (spot) VXST value is

³ CBOE Futures Exchange, LLC (“CFE”) plans to launch trading VXST futures during the first quarter in 2014 and prior to launching VXST options on CBOE.

⁴ The VXST index is calculated in the same manner as other volatility indexes, e.g., VIX, upon which options have been based and previously approved by the SEC. A more detailed explanation of the method used to calculate VIX may be found on the CBOE’s website at: <http://www.cboe.com/micro/vix/vixwhite.pdf>.

calculated using premium quotations and the exercise settlement value for VXST options will be calculated using the actual opening premium prices of the constituent S&P 500 index options on the expiration day of the respective VXST option. The VXST index was introduced by CBOE on October 1, 2013 and has been disseminated at least once a day on every trading day since that time.

The VXST index measures a nine day period of expected (implied) volatility and is calculated based on real-time prices of options on the S&P 500 index that expire in nine days. Specifically, the constituent S&P 500 index options that expire on a Friday (i.e., nine days from the VXST expiration date, which is typically a Wednesday in the preceding week) may include the following types of options on the S&P 500 index: standard monthly options, End-of-Week (“EOW”) expirations⁵ and Quarterly Index (“QIX”) expirations.⁶ The chart below illustrates the different types of S&P 500 index options that would be used to calculate the VXST index:

August 2016/September 2016						
S	M	T	W	T	F	S
28	29	30	31	1	2	3
			VXST expiration			
4	5	6	7	8	9	10
			VXST expiration		P.M.-settled EOW	
11	12	13	14	15	16	17
			VXST expiration		A.M.-settled standard	
18	19	20	21	22	23	24
			VXST expiration		P.M.-settled EOW	
25	26	27	28	29	30	
					P.M.-settled QIX	

Because some of the constituent options used to calculate the VXST index are A.M.-settled and some are P.M.-settled, the amount of time covered by a specific contract will vary slightly depending on the type of series used for any given A.M.-settled VXST option. For a

⁵ Listed under Rule 24.9(e).

⁶ Listed under Rule 24.9(c).

VXST option contract calculated using A.M.-settled standard S&P 500 index options, the period of implied volatility covered by the contract will be exactly nine days. For a VXST option contract calculated using P.M.-settled EOW or QIX on the S&P 500 index, the period of implied volatility covered by the contract will be nine days, plus 390 minutes.⁷

The VXST calculation generally uses nearby and second nearby option expirations with at least 1 day left to expiration and then weights them to yield a constant, nine-day measure of the expected volatility of the S&P 500 index. The quantity of S&P 500 index option series used to calculate the VXST at any given time will range from an average of 60 series at settlement to 120 or more series at other times.

For each VXST contract expiration, 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 nine-day measure of volatility.

CBOE will compute values for VXST underlying option series on a real-time basis throughout each trading day, from approximately 8:30 a.m. (Chicago time) until approximately

⁷ P.M.-settled, expiring EOWs and QIX stop trading at 3:00 p.m. (Chicago time) on their last day of trading. See Rules 24.9(e)(4) and 24.6.01. The additional 390 minutes reflects that the constituent options trade for six and a half hours on their expiration date until 3:00 p.m. (Chicago time).

3:15 p.m. (Chicago time). VXST levels will be calculated by CBOE and generally disseminated at 15-second intervals to major market data vendors.⁸

Options Trading

VXST options would be quoted in index points and fractions and one point will equal \$100. The minimum tick size for series trading below \$3 would be 0.05 (\$5.00) and above \$3 will be 0.10 (\$10.00). The Exchange would be permitted to list up to 12 near-term VXST option expiration weeks and new series would be permitted to be added up to and including on the last day of trading for an expiring VXST option contract.⁹ The trading hours for VXST options would be from 8:30 a.m. to 3:15 p.m. (Chicago time). Exhibit 3 presents contract specifications for VXST options.

The Exchange is proposing to establish a strike price setting regime for VXST options similar to what is permitted for VIX options and, in part, what is permitted for short term option series (or weekly options) on volatility based-exchange traded products.¹⁰ Specifically, the Exchange proposes to permit \$0.50 strike price (or greater) intervals for VXST options where the

⁸ When VIX options and VXST options expire on the same day, as the calculator of volatility indexes, CBOE would not begin disseminating the spot (cash) values for any volatility index that CBOE calculates until the S&P 500 index option (SPX) series that CBOE will use to calculate the exercise settlement value for VIX options have opened. On all other VXST option expiration days, as the calculator of volatility indexes, CBOE would not begin disseminating the spot (cash) values for any volatility index that CBOE calculates until the S&P 500 index option series that CBOE will use to calculate the exercise settlement value for VXST options have opened. See CBOE Information Circular IC13-068, which CBOE will revise prior to the launch of trading VXST futures and VXST options.

⁹ See proposed amendments to Rule 24.9(a)(2) and 24.9.01(c). The Exchange is proposing to permit new VXST series to be added up to and on the last day of trading for expiring contracts. This is similar to the series setting schedule for short-term (weekly) options, which may be added up to and including on their expiration date. See Rules 5.5(d)(4) and 24.9(a)(2)(A)(iv).

¹⁰ See proposed Interpretation and Policy .01(i) to Rule 24.9 permitting the described strike price interval setting regime.

strike price is less than \$75 because the Exchange believes that more granular strike price intervals will provide investors with greater flexibility by allowing them to establish positions that are better tailored to meet their investment objectives. Fifty cent strike price (or greater) intervals are currently permitted for VIX (and other volatility index) options where the strike price is less than \$75.¹¹ In addition, \$0.50 strike price (or greater) intervals are permitted for short term options series (or weekly options) on volatility based exchange-traded products.¹² Next, the Exchange proposes to permit \$1 strike price (or greater) intervals for VXST options where the strike price is \$200 or less. The Exchange notes that \$1 strike price (or greater) intervals where the strike price is \$200 or less are permitted for VIX options pursuant to Rule 24.9.01(l). Finally, the Exchange proposes to permit \$5 strike price (or greater) intervals for VXST options whether [sic] the strike price is greater than \$200. The Exchange notes that \$5 strike price (or greater) intervals where the strike price is more than \$200 are permitted for VIX options pursuant to Rule 24.9.01(l).

The Exchange is proposing to set forth the above described strike interval setting regime for VXST options in new Interpretation and Policy .01(i) to Rule 24.9. The Exchange is also

¹¹ VIX options are used to calculate the CBOE VVIX index (aka “VIX of VIX” index). Because VIX options are used to calculate a volatility index, \$0.50 strike price intervals are permitted for VIX options where the strike price is less than \$75. See Rule 24.9.12.

¹² The strike price interval for standard options on exchange-traded products (“ETPs”), such as exchange-traded funds and exchange-traded notes, is \$1 or greater where the strike price is \$200 or less. See Rules 5.5.08 and 5.5.09. The strike price interval for ETP options that are in the short-term option series program (or weekly program) may be \$0.50 or greater where the strike price is less than \$75. See Rule 5.5(d)(5). For example, \$0.50 strike price intervals are permitted for weekly options on the iPath S&P 500 VIX Short-Term Futures ETN (“VXX”). The Exchange is not proposing to harmonize the strike price setting parameters for VXST options with weekly options, but instead is proposing to adopt a strike price setting regime similar to VIX options. The Exchange believes that market participants will expect the strikes price intervals for VXST options to be the same as permitted for VIX options. In addition, the Exchange believes that [sic] is desirable to have harmonized strike price interval rules for all of its volatility index options.

proposing to add new Interpretation and Policy .23 to Rule 5.5, Series of Option Contracts Open for Trading, which would be an internal cross reference stating that the intervals between strike prices for VXST option series will be determined in accordance with proposed new Interpretation and Policy .01(i) to Rule 24.9.

The Exchange is proposing to make a technical change to Rule 24.9.12, which permits \$0.50 and \$1 strike price intervals for index options used to calculate volatility indexes. Specifically, the Exchange is proposing to add “and \$150” to the rule text as those two words were inadvertently omitted from the proposed rule text changes to Rule 24.9.12 contained in original rule filing, but were described in detail in the purpose section.¹³

Exercise Settlement Value, Expiration Date and Last Trading Day

The Exchange proposes to set forth in new subparagraph (a)(6) to Rule 24.9 that the exercise settlement value for the proposed VXST options would be calculated on the specific date (usually a Wednesday) identified in the option symbol for the series.¹⁴ If that Wednesday or the Friday in the business week following that Wednesday (*i.e.*, nine days away) is an Exchange holiday, the exercise settlement value would be calculated on the business day immediately preceding the Wednesday.

On the day the exercise settlement value is calculated for VXST options, modified Hybrid Opening System (“HOSS”) opening procedures would be used to calculate the exercise

¹³ See Securities Exchange Act Release 64189 (April 5, 2011), 76 FR 20066 (April 11, 2011) (order granting approval of proposed rule change to permit the listing of series within [sic] \$0.50 and \$1 strike price increments on certain options used to calculate volatility indexes) (SR-CBOE-2011-008).

¹⁴ Options symbols are made up of 17 to 21 characters, depending on the length of the symbol representing the underlying security. Symbols are constructed as follows: Symbol + Expiration Date (Year, Month, Day) + Call or Put + Strike Price (in dollars to three decimal places).

settlement value for VXST options.¹⁵ The Exchange recently amended Rule 6.2B.08 to establish modified HOSS opening procedures for all Hybrid classes and series used to calculate volatility indexes.¹⁶ The Exchange notes that Rule 6.2B.01 sets forth similar procedures for Hybrid 3.0 classes that are used to calculate volatility indexes. As explained in more detail in SR-CBOE-2013-102, the different types of options on the S&P 500 index that will be used to calculate the VXST trade on different platforms, e.g., standard S&P 500 index options are Hybrid 3.0 series and EOW on the S&P 500 index are Hybrid series. As a result, Rules 6.2B.01 and 6.2B.08 would apply to the constituent option series in the VXST, as relevant. Accordingly, CBOE is proposing to amend each of those rules to reflect this fact.

The exercise settlement value of a VXST option would be calculated by the Exchange as a Special Opening Quotation (“SOQ”) of VXST using the sequence of opening prices of the options that comprise the VXST index. The opening price for any series in which there is no trade would be the average of that option’s bid price and ask price as determined at the opening of trading. The “time to expiration” used to calculate the SOQ shall account for the actual number of days and minutes until expiration for the constituent option series. For example, if the Exchange announces that the opening of trading in the constituent option series is delayed, the amount of time until expiration for the constituent option series used to calculate the exercise settlement value would be reduced to reflect the actual opening time of the constituent option series. Another example would be when the Exchange is closed on a Wednesday due to an Exchange holiday, the amount of time until expiration for the constituent option series used to

¹⁵ The main feature of the modified HOSS opening procedures is the strategy order cut-off time for the constituent option series that will be used to calculate the exercise settlement value of a volatility index.

¹⁶ Securities Exchange Act Release No. 71073 (December 13, 2013), 78 FR 76664 (December 18, 2013) (order approving SR-CBOE-2013-102).

calculate the exercise settlement value would be increased to reflect the extra day of trading in the constituent option series.

The expiration date of a VXST option would be on the same day that the exercise settlement value of the VXST option is calculated. The last trading day for a VXST option would be the business day immediately preceding the expiration date of the VXST option (typically a Tuesday). For example, the Dec 10 14 VXST option would expire on Wednesday, December 10, 2014 and trading in that expiring contract would cease at 3:15 p.m. (Chicago time) on Tuesday, December 9, 2014. When the last trading day is moved because of an Exchange holiday, the last trading day for an expiring VXST option contract would be the day immediately preceding the last regularly scheduled trading day.

Exercise would result in delivery of cash on the business day following expiration. VXST options would be A.M.-settled.¹⁷ The exercise-settlement amount would be equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by \$100.

Position and Exercise Limits

The Exchange is not proposing to establish any position and exercise limits for VXST options.¹⁸ Because the VXST is calculated using options on the S&P 500 Index (for which there are no position and exercise limits) the Exchange believes that VXST options should similarly have not [sic] position and exercise limits. In addition, the Exchange notes that VIX options also

¹⁷ See proposed amendment to Rule 24.9(a)(4) (adding VXST to the list of A.M.-settled index options approved for trading on the Exchange). The Exchange is also proposing to make a technical change to this rule to distinguish existing 30-day volatility period contracts from VXST options.

¹⁸ See proposed amendment to Rules 24.4, Position Limits for Broad-Based Index Options, and 24.5, Exercise Limits (adding VXST to the list of products for which there are no position limits and no exercise limits, respectively).

do not have position and exercise limits. Exercise limits for VXST options would be the equivalent to the proposed position limits. VXST options will be subject to the same reporting requirements triggered for other options dealt in on the Exchange.¹⁹

Margin

The Exchange proposes that VXST options be margined as “broad-based index” options, and under CBOE rules, especially, Rule 12.3(c)(5)(A), the margin requirement for a short put or call shall be 100% of the current market value of the contract plus up to 15% of the “product of the current index group value and the applicable index multiplier.” Additional margin may be required pursuant to Rules 12.3(h) and 12.10, Margin Required is Minimum.

Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX and Chapter XXIV would equally apply to VXST options.

Capacity

CBOE has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority (“OPRA”) have the necessary systems capacity to handle the additional traffic associated with the listing of new series that would result from the introduction of VXST options. The Exchange notes that VXST options would expire weekly and the Exchange is proposing to permit the listing of up to 12 expirations at one time. In comparison, over 300 classes participate in the industry wide weekly option series program and the Exchange and OPRA have been able to handle and absorb the traffic associated with that program (which continues to expand and increase). Because the proposal is limited to a single class and a

¹⁹ See proposed amendments to Interpretations and Policies .03, Reporting Requirement, and .04, Margin and Clearing Firm Requirements, to Rule 24.4 (adding VXST to each of these provisions).

maximum number of expirations that may be listed at one time, the Exchange believes that the additional traffic that would be generated from VXST options will be manageable.

Surveillance

The Exchange would use the same surveillance procedures currently utilized for each of the Exchange's other index options to monitor trading in VXST options. The Exchange would also utilize enhanced surveillance procedures at expiration, several of which would be automated. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in VXST options. For surveillance purposes, the Exchange would 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 the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.²⁰ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)²¹ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

Specifically, the Exchange believes that there is an unmet market demand for options that expire each week that measure a short-term volatility period. As described above, VXST options are designed to respond to that unmet market demand and CBOE believes that VXST options will provide an opportunity for investors to hedge or speculate on the market risk associated with change in implied volatility that measure a nine day period.

²⁰ 15 U.S.C. 78f(b).

²¹ 15 U.S.C. 78f(b)(5).

The success of CBOE's VIX options that measure a 30 day period illustrate the prominence that volatility products have taken over the past several years. CBOE seeks to enlarge its suite of volatility products by introducing a new volatility index option that will provide investors with a contract that expires every week that measures a shorter volatility duration than existing VIX options. CBOE believes that VXST options will provide investors with additional opportunities to manage volatility risk that ranges over different time periods.

CBOE has many years of history and experience in conducting surveillance for volatility index options trading to draw from in order to detect manipulative trading in the proposed VXST options. Additionally, the Exchange represents that it has the necessary systems capacity to support the introduction of VXST options.

The Exchange believes that the proposed strike interval setting regime is designed to promote just and equitable principles of trade and is consistent with the strike interval setting regimes for other volatility index options and, in part, for other weekly products. In fact, the Exchange believes that the establishment of the proposed ability to list \$.50 (or greater) strike price intervals where the strike price is less than \$75 is needed for competitive reasons because it will allow the Exchange to list strike price intervals for VXST options at the same level of granularity permitted for competitor products, such as weekly VXX options. Additionally, the Exchange believes that it [sic] desirable to have strike price setting regimes that are harmonized for all volatility index options.

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. Specifically, CBOE believes that the introduction of a new volatility index option product will enhance

competition among market participants and will provide a new type of weekly expiration that can compete with products such as VXX weekly options to the benefit of investors and the marketplace.

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 Exchange 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. Please include File Number SR-CBOE-2014-003 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-2014-003. 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-2014-003 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.²²

Kevin M. O'Neill
Deputy Secretary

²² 17 CFR 200.30-3(a)(12).