

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72468; File No. SR-CBOE-2014-039)

June 25, 2014

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change as Modified by Amendment No. 1 to Amend Certain Margin Rules for Volatility Index Options

I. Introduction

On April 28, 2014, the Chicago Board Options Exchange, Incorporated (the “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 (the “Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend certain margin rules for volatility index options. The proposed rule change was published for comment in the Federal Register on May 13, 2014.³ The Commission received no comment letters regarding the proposed rule change. On June 10, 2014, CBOE filed Amendment No. 1 to the proposed rule change.⁴ This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposed Rule Change

CBOE proposes to amend certain margin rules for volatility index options. Over the past decade, CBOE has received approval from the Commission to list options on different types of volatility indexes, including volatility indexes comprised of options on: (1) broad-based indexes, (2) individual stocks; and (3) exchange traded funds (“ETFs”). For each volatility index

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 72115 (May 7, 2014), 79 FR 27358 (“Notice”).

⁴ In Partial Amendment No. 1, CBOE requested that the implementation date for the rule be 30 days from the date of this approval order (“Amendment No. 1”). Amendment No. 1 does not change any of the proposed rule text that was submitted in the original filing. Amendment No. 1 is technical in nature and, therefore, the Commission is not publishing it for comment.

comprised of broad-based index options, the Exchange received approval from the Commission to classify each respective volatility index as a “broad-based index” for margin purposes.⁵ For stock and ETF-based volatility indexes, the margin requirements were set at the same levels that apply to equity options.⁶

The Exchange is proposing to amend CBOE Rules 12.3 (Margin Requirements) and 12.4 (Portfolio Margin) to increase the minimum margin requirements for certain 30-day volatility index options and for options on the VXST Index, which is designed to reflect investors’ consensus view of 9-day expected stock market volatility.⁷ To affect these changes as new minimum margin requirements going forward, the Exchange is proposing to add the proposed margin levels to the text of CBOE Rules 12.3 and 12.4. Specifically, CBOE believes the proposal rule changes will make the rule text more “user-friendly” by enumerating “Volatility Indexes” and identifying specific classes in the appropriate places.

Proposed Changes to CBOE Rule 12.3(c)(5)

CBOE Rule 12.3(c)(5) sets forth the initial and maintenance margin requirements for

⁵ See Securities Exchange Act Release Nos. 49563 (April 14, 2004), 69 FR 21589 (April 21, 2004) (order approving SR-CBOE-2003-40 to list options on the CBOE Volatility Index (“VIX”), the CBOE Nasdaq 100 Index Volatility Index (“VXN”) and the CBOE Dow Jones Industrial Index (“VXD”)), 55425 (March 8, 2007), 72 FR 12238 (March 15, 2007) (order approving SR-CBOE-2006-73 to list options on the CBOE Russell 2000 Volatility Index (“RVX”)), and 71764 (March 21, 2014), 79 FR 17212 (March 27, 2014) (order approving SR-CBOE-2014-003 to list options on the CBOE Short-Term Volatility Index (“VXST”)).

⁶ See Securities Exchange Act Release Nos. 62139 (May 19, 2010), 75 FR 29597 (May 26, 2010) (order approving SR-CBOE-2010-018 to list options on the CBOE Gold ETF Volatility Index (“GVZ”), and 64551 (May 26, 2011), 76 FR 32000 (June 2, 2011) (order approving SR-CBOE-2011-026 to list options on the CBOE Equity VIX on Apple (“VXAPL”), the CBOE Equity VIX on Amazon (“VXAZN”), the CBOE Equity VIX on Goldman Sachs (“VXGS”), the CBOE Equity VIX on Google (“VXGOG”), the CBOE Equity VIX on IBM (“VXIBM”), the CBOE Crude Oil ETF Volatility Index (“OVX”), the CBOE Emerging Markets ETF Volatility Index (“VXEEM”), the CBOE China ETF Volatility Index (“VXFXI”), the CBOE Brazil ETF Volatility Index (“VXEWZ”), the CBOE Gold Miners ETF Volatility Index (“VXGDX”) and the CBOE Energy Sector ETF Volatility Index (“VXXLE”)).

⁷ See Notice, *supra* note 3, at 27358.

short options held in a customer account. As stated above, when the Commission approved the VIX, VXN, VXD, RVX and VXST options for trading, the Exchange was permitted to margin these products as “broad-based index” options. The first chart in CBOE Rule 12.3(c)(5) sets forth at paragraph 3 that the initial and/or maintenance margin required for broad-based index options is the greater of: 100% of the current market value of the option plus 15% of the current underlying component value less any out-of-the-money amount or 100% of the current market value of the option plus 10% of the current underlying component value.⁸ The “underlying component value” for broad-based index options is the product of the current index group value and the applicable index multiplier. The Exchange believes that the 15% initial and/or maintenance margin component should be increased to 20% for 30-day volatility index options and to 40% for 9-day volatility index options (VXST), which were approved to be treated as “broad-based index” options for margin purposes. For 9-day volatility index options (VXST), the Exchange also believes that the 10% minimum margin required should be increased to 20%.⁹ The Exchange is not proposing to increase the 10% minimum margin required for 30-day volatility index options.¹⁰

To affect this change, the Exchange proposes to amend existing paragraph 15 to the first chart set forth in CBOE Rule 12.3(c)(5). Paragraph 15 currently sets forth the initial and/or maintenance margin required and minimum margin required for individual stock or ETF-based volatility indexes (whose margin requirements the Exchange is not proposing to change). The

⁸ There is one difference in the case of a put option. For the 10% minimum only, 10% of the put’s exercise price is required rather than 10% the current underlying component value.

⁹ Prior to the April 10, 2104 launch of trading in VXST options, the Exchange exercised its authority under CBOE Rules 12.3(h) and 12.10 to impose higher initial and maintenance margin requirements for short, uncovered VXST options. See CBOE Regulatory Circular [RG14-040](#) (Margin Requirements for VXST Options).

¹⁰ See Notice, supra note 3, at 27358.

Exchange is proposing to amend paragraph 15 to expand its application to all volatility indexes. Specifically, the Exchange proposes to set forth “Volatility Indexes” as the type of option and to set forth below that heading the specific volatility index option classes that are currently listed for trading (i.e., VIX, RVX, VXST, GVZ, OVX, VXEEM and VXEWS).¹¹

The Exchange also proposes to include a category under “Volatility Indexes” labeled, “Other Volatility Indexes identified in Rules 24.9(a)(3) and 24.9(a)(4)”¹² because the Exchange has received approval to trade options on certain volatility indexes, which are not currently listed for trading. The Exchange also proposes to amend the definition for “index value” for volatility indexes in Row IV (Underlying Component Value) to the first chart in CBOE Rule 12.3(c)(5) in order to be more clear. Specifically, the Exchange proposes to add the descriptive phrase, “current (spot or cash)” so that the CBOE Rule 12.3(c)(5) is clear on its face that the current (spot or cash) value for a volatility index is used to calculate margin requirements.¹³

The Exchange is also proposing to delete “Individual Stock or ETF Based” from the Option or Warrant Issue column from the second chart in CBOE Rule 12.3(c)(5) and replace it with “Volatility Indexes.” In addition, the Exchange is proposing to add the descriptive phrase “(spot or cash)” before the references to “current index value” in the Call and Put rows. These changes conform to the changes described above regarding the new category of “Volatility Indexes” and provide clarity as to what is meant by “current index value” for volatility index options.

¹¹ See Notice, supra note 3, at 27359.

¹² CBOE Rules 24.9(a)(3) (European-style index options approved for trading) and 24.9(a)(4) (A.M.-settled index options approved for trading) identify, among other indexes, all other volatility indexes that have approved for options trading but which are not currently listed for trading.

¹³ See Notice, supra note 3, at 27359.

Proposed Changes to CBOE Rule 12.4

As an alternative to the margin requirements set forth in CBOE Rule 12.3, CBOE Rule 12.4 (Portfolio Margin) permits Trading Permit Holder organizations to compute a margin requirement for option positions carried for customers using a portfolio (or risk-based) approach. CBOE proposes to amend CBOE Rule 12.4 to identify “Volatility Index (30-day implied)” and “Volatility Index (9-day implied)” as portfolio types in the chart set forth in CBOE Rule 12.4 and to specify “+/-20%” and “+/- 40%”) as the respective applicable up/down market move (high & low valuation points).¹⁴ The Exchange believes that specifying “Volatility Index (30-day implied)” and “Volatility Index (9-day implied)” as portfolio types would make finding the applicable portfolio margin levels easier for users of CBOE’s rulebook. The Exchange notes that this proposed change would increase the applicable up/down market move (high & low valuation points) for all of its volatility index options.¹⁵

The Exchange is proposing to delete the four footnote 1 references and the text of footnote 1 from the chart set forth in CBOE Rule 12.4. The text of the footnote reads, “In accordance with sub-paragraph (b)(1)(i)(B) of Rule 15c3-1a under the Securities Exchange Act of 1934.”¹⁶ The Exchange also proposes to amend subparagraph (a)(9) to CBOE Rule 12.4, which sets forth the definition for “underlying instrument” as meaning “a security or security index upon which any listed option, unlisted derivative, security futures product or related

¹⁴ Prior to the April 10, 2104 launch of trading in VXST options, the Exchange exercised its authority under CBOE Rule 12.10 to provide that the magnitude of the valuation point range under CBOE Rule 12.4 for VXST options held in a portfolio margin is +/-40% and that the price of the VXST futures contract with a corresponding expiration will be used to calculate theoretical gains and losses for VXST options. See CBOE Regulatory Circular [RG14-056](#) (Margin Requirements for VXST Options).

¹⁵ See Notice, supra note 3, at 27359.

¹⁶ See id. at 27359.

instrument is based. The term underlying instrument shall not be deemed to include, futures contracts, options on futures contracts or underlying stock baskets.” The Exchange proposes to amend that definition by adding the following phrase at the end of the definition, “except that, for the purpose of calculating theoretical gains and losses for a listed option, unlisted derivative, or security futures product overlying a volatility index pursuant to this Rule, the price of a futures contract referencing the same volatility index may be utilized in lieu of the current (spot or cash) index value.” The Exchange is proposing to make this change because a more accurate theoretical price for a volatility index option is obtained, and thus a more accurate portfolio margin requirement is derived, by using the price of a futures contract that references the same volatility index. Market participants price volatility index options in view of the price a futures contract that references the same volatility index, rather than using the cash or spot index value.¹⁷

In addition, the Exchange proposes to amend subparagraph (d)(3)(ii) to CBOE Rule 12.4 to add volatility index options to the list of eligible positions for portfolio margin. Finally, the Exchange proposes to make a technical change earlier in Rule 12.4(a)(5) to delete the unnecessary word “and” from the definition of “option series.”¹⁸

Ongoing Analysis Regarding Margin Levels

The Exchange will continue to analyze and review the appropriate minimum margin levels for volatility index option. Specifically, the Exchange will continue to review market data in order to determine whether the proposed margin levels should remain or be adjusted. Among other things, CBOE may propose an alternate methodology for determining margin levels or

¹⁷ See id.

¹⁸ See id.

CBOE may subsequently change margin levels after having time to study the impact of the proposed rule change. Any such change would be accomplished by way of a rule filing with the Commission.¹⁹

Implementation Date

CBOE filed Amendment No. 1 to request a 30-day implementation period for the proposed rule that would commence upon approval of the proposed rule change.²⁰ The Exchange believes that this is an appropriate timeframe for Trading Permit Holder organizations and their customers to prepare for the proposed margin increases.

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.²¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²² which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that increasing the minimum margin requirements (including the portfolio margin requirements) for certain volatility index options will protect the integrity of the

¹⁹ See id. at 27359-60.

²⁰ See Amendment No. 1.

²¹ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²² 15 U.S.C. 78f(b)(5).

marketplace by setting margin at a level that is appropriate for the given instrument. The proposed changes also will benefit investors and other market participants by making some clarifying changes to CBOE's margin rules, and by making CBOE's rules more user-friendly in that the applicable margin levels will be easier to locate in CBOE's rulebook.

Finally, the implementation date of the proposed rule change will be 30 days from the effective date of this approval order. The Commission believes that a 30 day implementation date is an appropriate timeframe for broker-dealers and their customers to prepare for the proposed margin increases.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²³ that the proposed rule change (SR-CBOE-2014-039), as modified by Amendment No. 1, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁴

Kevin M. O'Neill
Deputy Secretary

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).