

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49698; File No. SR-CBOE-2004-09)

May 13, 2004

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Options on Certain CBOE Volatility Indexes

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 February 17, 2004, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”), 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 Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to approve the proposal on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The CBOE hereby proposes to amend certain of its rules to provide for the listing and trading of options on three separate volatility indexes; specifically: the CBOE Increased-Value Volatility Index (“Increased-Value VIX”); the CBOE Increased-Value Nasdaq 100® Volatility Index (“Increased-Value VXN”); and the CBOE Increased-Value Dow Jones Industrial Average® Volatility Index (“Increased-Value VXD”) (collectively, “Increased-Value Volatility Indexes”). Options on each index would be cash-settled and would have European-style expiration. The text of the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

change is set forth below. Proposed new language is in italics; proposed deletions are in [brackets].

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CHAPTER XXIV

Index Options

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Rule 24.1 Definitions

(a) - (x) No change.

... Interpretations and Policies:

.01 The reporting authorities designated by the Exchange in respect of each index underlying an index option contract traded on the Exchange are as follows:

Index	Reporting Authority
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[Add the following to the current list:]

CBOE Increased-Value Volatility Index®.....Chicago Board Options Exchange

CBOE Increased-Value Nasdaq 100® Volatility Index ..Chicago Board Options

Exchange

CBOE Increased-Value Dow Jones Industrial Average® Volatility Index...Chicago Board

Options Exchange

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Rule 24.9 Terms of Index Option Contracts

(a) General.

(1) - (2) No change.

(3) European-Style Exercise. The following European-style index options, some of which are A.M.-settled as provided in paragraph (a)(4), are approved for trading on the Exchange:

[Add the following to the end of the current list]

CBOE Increased-Value Volatility Index®

CBOE Increased-Value Nasdaq 100® Volatility Index

CBOE Increased-Value Dow Jones Industrial Average® Volatility Index

(4) A.M. Settled Index Options. The last day of trading for A.M.-settled index options shall be the business day preceding the last day of trading in the underlying securities prior to expiration. The current index value at the expiration of an A.M.-settled index option shall be determined, for all purposes under these Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration, by reference to the reported level of such index as derived from first reported sale (opening) prices of the underlying securities on such day, except that in the event that the primary market for an underlying security does not open for trading, halts trading prematurely, or otherwise experiences a disruption of normal trading on that day, or in the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading, halts trading prematurely, or otherwise experiences a disruption of normal trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 24.7(e).

The following A.M.-settled index options are approved for trading on the Exchange:

[Add the following to the end of the current list]

CBOE Increased-Value Volatility Index®

CBOE Increased-Value Nasdaq 100® Volatility Index

CBOE Increased-Value Dow Jones Industrial Average® Volatility Index

(5) Other Methods of Determining Exercise Settlement Value. Exercise settlement values for the following index options are determined as specified in this paragraph:

(i) – (iii) No Change.

(iv) CBOE Volatility Indexes and CBOE Increased-Value Volatility Indexes.

The current index value at expiration shall be determined, for all purposes under these Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration. The current index value for such purposes shall be calculated by the Chicago Board Options Exchange as a Special Opening Quotation (SOQ) of each respective Volatility or Increased-Value Volatility Index using the sequence of opening prices of the options that comprise each Index. The opening price for any series in which there is no trade shall be the average of that option's bid price and ask price as determined at the opening of trading.

(b) - (c) No change.

... Interpretations and Policies:

.01 The procedures for adding and deleting strike prices for index options are provided in Rule 5.5 and Interpretations and Policies related thereto, as otherwise generally provided by Rule 24.9, and include the following:

(a) The interval between strike prices will be no less than \$5.00; provided, that in the case of the following classes of index options, the interval between strike prices will be no less than \$2.50:

[Add the following to the end of the current list]

CBOE Increased-Value Volatility Index®

CBOE Increased-Value Nasdaq 100® Volatility Index

CBOE Increased-Value Dow Jones Industrial Average® Volatility Index

(b) – (d) No change.

.02 - .11 No change.

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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 CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The proposed rule change would permit the Exchange to list and trade cash-settled, European-style options on increased-value versions of existing volatility indexes, specifically, the CBOE Volatility Index (“VIX”); the CBOE Nasdaq 100® Volatility Index (“VXN”); and the CBOE Dow Jones Industrial Average® Volatility Index

(“VXD”).³ According to the CBOE, each of the existing volatility indexes – VIX, VXN, and VXD – is calculated using real-time quotes of out-of-the-money nearby and second nearby index puts and calls of the S&P 500® Index (“SPX®”), the Nasdaq 100® Index (NDX®) and the Dow Jones Industrial Average® Index (“DJX®”), respectively.

Generally, volatility indexes provide investors with up-to-the-minute market estimates of expected volatility of the corresponding securities index that each particular volatility index tracks. For example, the VIX tracks the expected volatility of the SPX®. The VIX, VXN, and the VXD are each calculated by extracting implied volatilities from real-time index option bid/ask quotes of the underlying securities indexes.

VIX, VXN, and VXD are all quoted in absolute numbers that represent the underlying stock index volatility in percentage points per annum. For example, an index level of 14.34 (the closing value of the VIX as of January 21, 2004) represents an annualized volatility of 14.34%. The Increased-Value Volatility Indexes would be calculated by simply multiplying the corresponding value of the VIX, VXN, and VXD, respectively, by ten. To illustrate, where the index level of the VIX would be 14.34 on January 21, 2004, the Increased-Value VIX would have an index value of 143.40 (ten times 14.34). Similarly, the index level of the increased-value versions of the VXN and the VXD always would be ten times the index level of the VXN and the VXD, respectively. Each of the Increased-Value Volatility Indexes would be listed and traded

³ The Commission recently granted approval for the CBOE to list options on the VIX, VXN, and VXD indexes. See Securities Exchange Act Release No. 49563 (April 14, 2004), 69 FR 21589 (April 21, 2004) (SR-CBOE-2003-40). Index description and option contract specifications related to options on VIX, VXN, and VXD are set forth in the related notice of the proposed rule change. See Securities Exchange Act Release No. 48807 (November 19, 2003), 68 FR 66516 (November 26, 2003) (SR-CBOE-2003-40).

under a unique symbol, to be determined at a later date by the Exchange. The CBOE would notify the Commission and The Options Clearing Corporation of these symbols. In addition, the Exchange would disseminate prices for Increased-Value Volatility Indexes every 15 seconds through the Option Price Reporting Authority.

The purpose of calculating and maintaining increased-value versions of CBOE's volatility indexes would be to offer additional investment and risk management alternatives to institutional customers. Based on past experience, CBOE believes that institutional customers would prefer a larger-sized contract that would be more sensitive to changes in the underlying index. Such a contract would be more consistent with customers' hedging needs. CBOE believes that having the flexibility to offer both sized volatility index products would permit the Exchange to better meet the needs of both institutional and retail investors

Index Design, Calculation, and Option Trading

Again, the Increased-Value Volatility Indexes would be designed and calculated by simply multiplying the index levels of the VIX, VXN, and VXD indexes by ten. The contract specifications for options on the Increased-Value Volatility Indexes would be the same as that of the VIX, VXN, and VXD. Strike prices would be set to bracket the index in 2 ½ point increments for strikes below 200 and in 5-point increments above 200. The minimum tick size for series trading below \$3 will be 0.05 and for series trading above \$3 the minimum tick would be 0.10. The trading hours for options on the Increased-Value Volatility Indexes would be from 8:30 AM to 3:15 PM CST.

Exercise and Settlement

Similarly, exercise and settlement on the Increased-Value Volatility Indexes would be identical to the existing volatility indexes. The proposed options on each Increased-Value Volatility Index would expire on the Wednesday immediately prior to the third Friday of each month. For example, February 2004 Increased-Value VIX options would expire on Wednesday, February 18, 2004. Increased-Value Volatility Index options would be A.M.-settled. The exercise settlement value would be determined by a Special Opening Quotation (“SOQ”) of each respective Increased-Value Volatility Index calculated from the sequence of opening prices of the options that comprise that 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 exercise-settlement amount would be equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by \$100. When the last trading day falls on an Exchange holiday, the last trading day for expiring options would be the day immediately preceding the last regularly-scheduled trading day. When the date on which the exercise settlement value is to be determined would fall on an Exchange holiday, the exercise settlement value would be determined on the day immediately preceding the regularly-scheduled settlement date.

Surveillance

The Exchange would use the same surveillance procedures currently utilized for each of the Exchange's other index options, including options on the VIX, VXN, and

VXD,⁴ to monitor trading in options on each Increased-Value Volatility Index. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in options on these indexes. For surveillance purposes, the Exchange would have complete access to information regarding trading activity in the pertinent underlying securities.

Position Limits

The Exchange proposes to establish position limits for options on each Increased-Value Volatility Index at 25,000 contracts on either side of the market and no more than 15,000 of such contracts would be able to be in series in the nearest expiration month. This would be consistent with CBOE Rule 24.4 (Position Limits for Broad-Based Index Options).

Exchange Rules Applicable

Except as modified herein, the Rules in Chapter XXIV would be applicable to the Increased-Value Volatility Index options. Each Increased-Value Volatility Index would be classified as a “broad-based index” and, under CBOE margin rules, specifically, Rule 12.3(c)(5)(A), the margin requirement for a short put or call on each respective index would be 100% of the current market value of the contract plus up to 15% of the respective underlying index value.

In accordance with CBOE Rule 24A.4(b) (Special Terms for FLEX Index Options), CBOE reserves the right to approve and open for trading FLEX options on the Increased-Value Volatility Indexes.

⁴ Id.

Additionally, CBOE affirms that it possesses the necessary systems capacity to support new series that would result from the introduction of Increased-Value Volatility Index options. CBOE also has been informed that OPRA has the capacity to support such new series.

The Exchange intends to issue a circular detailing index and option contract specifications to CBOE membership prior to the listing of options series on the Increased-Value Volatility Indexes.

2. Statutory Basis

CBOE believes that the proposed rule change is consistent with Section 6(b) of the Act,⁵ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁶ in particular, in that it would permit trading in options based on the Increased-Value Volatility Indexes pursuant to rules designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade, and thereby would provide investors with the ability to invest in options based on an additional index.

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.

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.

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).

III. 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-2004-09 on the subject line.

Paper comments:

Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-09. 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 Web site (<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 inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection

and copying at the principal office of the CBOE. 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-2004-09 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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. In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act.⁷ Specifically, The Commission believes that the proposed change does not raise any significant regulatory issues that were not addressed in the Commission's prior approval order regarding the listing and trading of options on the VIX, VXN and VXD on the CBOE.⁸ The proposed rule change would merely expand upon the existing list of indexes underlying index option contracts traded on the Exchange to include increased-value versions of existing volatility indexes, i.e. the Increased-Value VIX, Increased-Value VXN, and Increased-Value VXD.

The CBOE has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register to accommodate the listing and trading of options on the Increased-Value VIX, Increased-Value VXN, and Increased-Value VXD. Accordingly, the

⁷ Id.

⁸ See supra note 3.

Commission finds good cause, pursuant to Section 19(b)(2) of the Act,⁹ for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register because these products are similar to other products currently trading on the CBOE.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-CBOE-2004-09), is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

J. Lynn Taylor
Assistant Secretary

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ Id.

¹¹ 17 CFR 200.30-3(a)(12).