

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50759; File No. SR-CBOE-2004-74)

November 30, 2004

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Options on Revised-Value Versions of the European-Style Exercise, P.M.-Settled Option Contract on the Standard & Poor's 100 Stock Index

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 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 and II below, which Items have been prepared by the CBOE. The Exchange has filed the proposal as a "non-controversial" rule change pursuant to Section 19(b)(3)(A)(iii) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission.<sup>5</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

The CBOE proposes to introduce for trading revised-value versions of the European-style, P.M.-settled option contract on the Standard & Poor's 100 Stock Index that is currently

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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> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> The CBOE asked the Commission to waive the 30-day operative delay. See Rule 19b-4(f)(6)(iii). 17 CFR 240.19b-4(f)(6)(iii).

listed and traded on the Exchange. The text of the proposed rule change is below. Proposed new language is in italics.

## CHAPTER XXIV

### Index Options

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#### Rule 24.9 – Terms of Index Option Contracts

Rule 24.9(a) – (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]

European-Style Exercise S&P 100 Index Options (XEO) (1/5<sup>th</sup> value), if the strike price is less than \$200.00.

(b) – (d) No change.

.02 - .11 No change.

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 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 aspects of such statements.

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

1. Purpose

Since July 2001, the Exchange has listed for trading cash-settled and P.M.-settled options with European-style exercise on the Standard & Poor's 100 Stock Index ("S&P 100 Index").<sup>6</sup> These options trade on the CBOE under the symbol XEO.<sup>7</sup> The purpose of this proposed rule change filing is to allow the Exchange to list European-style exercise, cash-settled, P.M.-settled options on (1) an increased-value version of the XEO, and (2) a reduced-value version of the XEO. The Exchange is proposing to offer these particular new versions of the XEO option to accommodate the needs of a broader range of investors than is currently served by listing options only on the XEO.

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<sup>6</sup> The S&P 100 Index is a broad-based, capitalization-weighted index that is based on 100 highly capitalized stocks from a broad range of industries. CBOE has traded cash-settled options with American-style exercise on the S&P 100 Index since 1983, under the trading symbol OEX.

<sup>7</sup> See Securities Exchange Act Release No. 44556 (July 16, 2001), 66 FR 38046 (July 20, 2001) (Notice of Filing and Immediate Effectiveness which allowed CBOE to list European-style exercise, cash-settled options on the XEO).

### Increased-Value Options on the XEO

CBOE proposes to list a European-style exercise, cash-settled, P.M.-settled option that is based on two times the value of the XEO (“Increased-Value XEO”). The Exchange believes that offering Increased-Value XEO options will attract large institutional customers who seek a greater exposure to the underlying component stocks that make up the S&P 100 Index. With one Increased-Value XEO contract, an institutional customer will be able to gain twice the exposure to the S&P 100 Index than with one normal XEO contract.

### Reduced-Value Options on the XEO

CBOE also proposes to list a European-style exercise, cash-settled, P.M.-settled option that is based on one-fifth (1/5<sup>th</sup>) the value of the XEO (“Reduced-Value XEO”). The Exchange believes that offering Reduced-Value XEO options will allow CBOE to attract additional business from customers that may not otherwise be able to invest in regular XEO or Increased-Value XEO options. To illustrate, currently an October XEO 545 call would cost an investor approximately \$710, whereas with a Reduced-Value XEO, the 1/5<sup>th</sup> version of the same call would only cost an investor \$142.<sup>8</sup> The Exchange believes that the Reduced-Value XEO will allow retail investors to obtain a hedge that is more proportionate to their respective positions in the stocks that comprise the S&P 100 Index and that will not require as large an outlay of capital as the regular XEO options.

The Exchange believes that both the Reduced-Value and Increased-Value options on the XEO should attract a wider range of investors and, in turn, create a more active and liquid trading environment for S&P 100 Index options. The Exchange will continue listing and trading the

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<sup>8</sup> Estimates are based on a randomly selected last sale price (intra day) for the 2004 OCT 545.00 call on the XEO during the September 15, 2004 trading day.

current XEO options contract and both the Increased-Value XEO options and the Reduced-Value XEO options will trade under their own respective trading symbols.

The Commission and The Options Clearing Corporation will be notified of the new trading symbols and CBOE will issue a circular detailing the option contract specifications to CBOE membership prior to the listing of options series on the Increased-Value and Reduced-Value XEO. Additionally, the Exchange will disseminate prices for the Increased-Value and Reduced-Value XEO contracts every 15 seconds through the Option Price Reporting Authority.

Strike price intervals on the Increased-Value XEO shall be identical to the strike price intervals for normal XEO options, which are currently set to bracket the S&P Index in 5-point increments. Strike prices for Reduced-Value XEO options will be set to bracket the index in 2 ½ point increments for strikes at or below 200 and in 5-point increments above 200. The minimum tick size for Increased-Value and Reduced-Value XEO series trading below \$3 will be 0.05 and for series trading above \$3 the minimum tick will be 0.10. The trading hours for Increased-Value and Reduced-Value XEO contracts will be from 8:30 AM to 3:15 PM CST.

#### Position Limits

Consistent with CBOE Rule 24.4(d), there are no position limits for broad-based index option contracts on the OEX,<sup>9</sup> or similarly, for XEO options.<sup>10</sup> The approval order giving CBOE the authority to list options on the XEO notes that, because the only difference between OEX and XEO options is the manner in which the respective contracts are exercised (i.e., “American-style” versus “European-style”), XEO series may also be traded without position limits for the

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<sup>9</sup> See Securities Exchange Act Release No. 44994 (October 26, 2001), 66 FR 55722 (November 2, 2001) (order approving CBOE’s rule change, which proposed the elimination of position and exercise limits for OEX, SPX, and DJX index options).

<sup>10</sup> See supra note 7.

purposes of CBOE Rule 24.4(d).<sup>11</sup> Similarly, the Exchange believes that Increased-Value and Reduced-Value XEO options are no different than the regular XEO options, other than the fact that one contract is based on twice the value of the S&P 100 Index, and one contract is based on one-fifth the value of the S&P 100 Index, respectively. As such, Increased-Value and Reduced-Value XEO options shall not be subject to any position limits.

#### Exercise and Settlement

Exercise and settlement on both the Increased-Value XEO and the Reduced-Value XEO options will be identical to existing XEO options. Series in both the Increased-Value XEO and the Reduced-Value XEO will expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 3:15 p.m. (CST) on the business day preceding the last day of trading in the component securities of the Index (ordinarily the Thursday before expiration Saturday, unless there is an intervening holiday). The exercise-settlement value of the Index at option expiration will be calculated by Standard and Poor's based on the exercise-settlement value, OEX, is calculated using the last (closing) reported sales price in the primary market of each component stock on the last business day before the expiration date. If a component security fails to open for trading, the exercise settlement value will be determined in accordance with CBOE Rules 24.7(e) and 24.9(a)(4). When the last trading day is moved because of Exchange holidays (such as when CBOE is closed on the Friday before expiration), the last trading day for expiring options will be Wednesday and the exercise settlement value of index options at expiration will be determined at the opening of regular trading on Thursday.

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<sup>11</sup> See supra note 9.

### S&P 100 Index Maintenance

Because the underlying S&P 100 Index is monitored and maintained by Standard and Poor's, Standard and Poor's will be responsible for making all necessary adjustments to the S&P 100 Index to reflect component deletions, share changes, stock splits, stock dividends (other than an ordinary cash dividend), and stock price adjustments due to restructuring, mergers, or spin-offs involving the underlying components. Some corporate actions, such as stock splits and stock dividends, require simple changes to the available shares outstanding and the stock prices of the underlying components. Other corporate actions, such as share issuances, change the market value of the Index and would require the use of an index divisor to effect adjustments.

### Surveillance

Because the S&P 100 Index underlying the increased-value and the reduced-value options remains unchanged, the Exchange will use the same procedures used in the surveillance of XEO options for surveillance in the trading of the Increased-Value XEO and Reduced-Value XEO options. Further, CBOE represents that these surveillance procedures are adequate to monitor the trading in both Increased-Value XEO and Reduced-Value XEO options, as well as in LEAPS on the same respective options.

### Margin

The S&P 100 Index is a "broad-based index" and, under CBOE margin rules the margin requirement for a short put or call on each respective Increased-Value XEO and Reduced-Value XEO option contract shall be 100% of the current market value of the contract plus up to 15% of the respective underlying index value.<sup>12</sup> More specifically, for purchases of puts or calls with more than 9 months until expiration, customers must deposit and continue to maintain 75% of

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<sup>12</sup> See CBOE Rule 12.3(c)(5)(A).

the total cost of the option's current market value. When time to expiration reaches 9 months, the option no longer has value for margin purposes. Purchases of puts or calls with 9 months or less until expiration must be paid for in full. Writers of uncovered puts or calls must deposit and continue to maintain 100% of the option proceeds plus 15% of the aggregate contract value (current index level x \$100) minus the amount by which the option is out-of-the-money, if any, subject to a minimum for calls of option proceeds plus 10% of the aggregate contract value and a minimum for puts of option proceeds plus 10% of the aggregate exercise price amount.<sup>13</sup>

The Exchange also notes that Interpretation and Policy .04 to CBOE Rule 24.4, which authorizes the imposition of additional margin in OEX positions, shall also apply to all XEO option series, which are based on the same underlying index as OEX option series.<sup>14</sup>

#### Other Exchange Rules Applicable

Except as modified herein, the Rules in Chapter XXIV will govern the trading of Increased-Value XEO and Reduced-Value XEO options on the Exchange. Additionally, 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 XEO and Reduced-Value XEO and, in accordance with CBOE Rule 24A.7(a)(i), because the Increased-Value XEO and Reduced-Value XEO are both broad-based indexes, there shall be no position or exercise limits for these FLEX index options. Finally, CBOE affirms that it possesses the necessary systems capacity to support new series that would result from the introduction of the aforementioned index options.

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<sup>13</sup> For calculating maintenance margin, the option's current market value, as opposed to the total cost/option proceeds method, must be used. Additional margin may be required pursuant to CBOE Rule 12.10.

<sup>14</sup> See supra note 7.

## 2. Statutory Basis

The Exchange believes that the addition of Increased-Value XEO and Reduced-Value XEO option series creates new investment options for a broader range of customers that will appeal to many institutions, professional traders, and investors. The Exchange believes that the introduction of these options will attract additional order-flow to the index floor and will increase liquidity in these options in the market in general. For these reasons, the Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>15</sup> in general, and in particular with Section 6(b)(5) of the Act<sup>16</sup> in that it is designed to promote just and equitable principles of trade as well as to protect investors and the public interest.

### 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.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange asserts that the foregoing proposed rule change has become effective upon filing pursuant to Section 19(b)(3)(A) of the Act<sup>17</sup> and Rule 19b-4(f)(6) thereunder<sup>18</sup> because it does not:

- (i) significantly affect the protection of investors or the public interest;
- (ii) impose any significant burden on competition; and

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

<sup>16</sup> 15 U.S.C. 78f(b)(5).

<sup>17</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>18</sup> 17 CFR 240.19b-4(f)(6).

(iii) become operative for 30 days from the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.

A proposed rule change filed under Rule 19b-4(f)(6)<sup>19</sup> normally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange satisfied the five-day pre-filing requirement. The Exchange further requested that the Commission waive the 30-day operative delay, as specified in Rule 19b-4(f)(6)(iii), and designate the proposed rule change to become operative on November 18, 2004. The Commission notes that the proposed rule change does not raise any new, novel or complex regulatory issues because the Exchange currently trades the XEO contracts.<sup>20</sup> The proposed rule change would permit a reduced value version and an increased value version of the XEO products to be traded. These products should accommodate the needs of a broader range of investors investing in the options market. The Commission believes, therefore, that it is consistent with the protection of investors and the public interest to waive the 30-day pre-operative period in this case, and has determined to designate the operative date to be November 18, 2004, the date requested by the Exchange.<sup>21</sup> Allowing the rule change to become operative on November 18, 2004 will allow the Exchange to begin listing and trading the new options as soon as possible after the November expiration and will allow investors to establish positions during the earliest portion of the monthly cycle.

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<sup>19</sup> 17 CFR 240.19b-4(f)(6).

<sup>20</sup> See supra note 7.

<sup>21</sup> For the purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>22</sup>

#### 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-2004-74 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-2004-74. 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

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<sup>22</sup> See Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C).

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-2004-74 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>23</sup> 17 CFR 200.30-3(a)(12).