

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51830; File No. SR-CBOE-2005-26)

June 13, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Terms of Index Option Contracts Listed on the Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,²² notice is hereby given that on March 16, 2005, 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 Exchange. On June 9, 2005, CBOE submitted Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and to grant accelerated approval to the proposed rule change, as amended.

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

The Exchange proposes to amend its rules relating to the terms of index option contracts listed on the Exchange. The text of the proposed rule change is below.

Proposed new language is in italics; deletions are in brackets.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Form 19b-4, dated June 9, 2005 (“Amendment No. 1). Amendment No. 1 replaced the original rule filing in its entirety. In Amendment No. 1, CBOE made certain clarifications to the proposed rule text by referencing Interpretation and Policy .12 to Rule 24.9 (determination of pricing sources used in the calculation of an index) and further clarified the rationale for pursuing this rule change.

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CHAPTER XXIV

Index Options

Rule 24.1 – Rule 24.8 No Change

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Rule 24.9 – Terms of Index Option Contracts

Rule 24.9. (a) General

(1) – (3) No Change.

(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] the opening [(opening)] prices of the underlying securities on such day, as determined by the market for such security selected by the Reporting Authority pursuant to Interpretation and Policy .12 to Rule 24.9, 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:

(i) - (lxxiv) No Change.

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

(i) No Change.

(ii) [Nasdaq 100 Stock Index. 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 Nasdaq Stock Market, Inc. (“Nasdaq”) and reported to the CBOE using the volume weighted prices (“VWPs”) of the securities underlying the Nasdaq-100 Index, which VWPs shall be calculated according to the then current volume-weighted averaging methodology developed by Nasdaq.

(iii) [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 - .12 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, 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 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 purpose of the proposed rule change is to clarify CBOE rules relating to the determination of opening prices for securities that underlie certain A.M.-settled index options traded on the Exchange and to clarify CBOE rules relating to the determination of the exercise settlement value for certain option contracts that are based on the Nasdaq 100 Index.

Currently, CBOE Rule 24.9(a)(4) provides that the current index value at expiration of an A.M.-settled index option is determined 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.” The Exchange believes it important to clarify in CBOE Rules that, although the settlement values of an A.M.-settled index are generally determined from the first reported sale of the securities that underlie the index, the specific methodology for ascertaining the opening prices is largely determined by factors outside of the CBOE’s control. Specifically, these factors include the fact that (1) the Reporting Authority⁴ for a particular index may not always be using the primary market for a particular index component security⁵ and/or (2) the opening price for any particular component security used to calculate the index may not always be the first reported sale of that security, regardless of whether the Reporting Authority is using the underlying security’s primary market as the pricing source.⁶

⁴ CBOE Rule 24.1(h) defines a Reporting Authority as “. . . in respect of a particular index means the institution or reporting service designated by the Exchange as the official source for calculating the level of the index from the reported prices of the underlying securities that are the bases of the index and reporting such level.”

⁵ Interpretation and Policy .12 to CBOE Rule 24.9 provides that, “[w]ith respect to any securities index on which options are traded on the Exchange, the source of the prices of component securities used to calculate the current index level at expiration is determined by the Reporting Authority for that index.”

⁶ Although the Reporting Authority has discretion in selecting the source (i.e. primary market or other securities exchange) of pricing for securities that underlie the index, the opening price must be determined in accordance with the rules of the securities exchange (or Nasdaq) that the Reporting Authority selects as the source of pricing to be used in the calculation of the index.

Additionally, and as is consistent with CBOE Rule 24.9(a)(4), the Reporting Authority will be required to use the opening price in the calculation of the index value, not the closing price from the previous trading day.

To emphasize factor (1) above, the Exchange proposes to reference existing Interpretation and Policy .12 to Rule 24.9⁷ in paragraph (4) to CBOE Rule 24.9(a). Regarding factor (2) above, there may be circumstances in which the opening price for a particular component(s) underlying an index may not be the first reported sale for that component. To illustrate, Nasdaq has recently received approval to utilize a single opening pricing methodology (“Nasdaq Official Opening Price”) for securities traded through Nasdaq.⁸ Through this new methodology, the Nasdaq Official Opening Price reported by Nasdaq for a security may not always be the first reported sale. As such, referring to opening prices as the “first reported sale,” as is currently described in CBOE Rule 24.9(a)(4), is simply not accurate.

Therefore, the Exchange proposes to amend CBOE Rule 24.9(a)(4), in part, (1) to eliminate reference to the term “first reported sale” and (2) to reflect that the opening prices of the underlying securities at expiration of an A.M.-settled index option will be determined by the market (securities exchange or Nasdaq) for such security selected by the Reporting Authority, as consistent with Interpretation and Policy .12 to Rule 24.9.

Additionally, this rule filing proposes to revise Rule 24.9(a)(5)(ii), which describes the manner in which Nasdaq determines the exercise settlement value for the Nasdaq 100 Index. Until recently, as described in Rule 24.9(a)(5)(ii), Nasdaq calculated the exercise

⁷ See supra at Note 4 and see also Securities Exchange Act Release No. 50269 (August 26, 2004); 69 FR 53755 (September 2, 2004) (Notice of Filing and Immediate Effectiveness of proposed rule change adding Interpretation and Policy .12 to Rule 24.9). Telephone conversation between Terri Evans, Special Counsel, Division of Market Regulation, Commission, and James Flynn, Attorney, CBOE, on June 10, 2005.

⁸ See Securities Exchange Act Release No. 50405 (September 16, 2004); 69 FR 57118 (September 23, 2004).

settlement value for the Nasdaq 100 Index using the volume weighted prices (“VWP”) of the securities underlying the Nasdaq 100 Index. Nasdaq now uses a new methodology that, essentially, relies on a single price of each security that underlies the Nasdaq 100 Index.⁹ As Nasdaq will no longer be using a special VWP methodology for calculating the exercise settlement value for the Nasdaq 100 Index and, relying instead on the general provision in CBOE Rule 24.9(a)(4),¹⁰ CBOE proposes to merely eliminate the VWP description entirely from CBOE Rule 24.9(a)(5).

2. Statutory Basis

Because these proposed amendments serve to clarify existing rules relating to the determination of the opening prices for the securities that underlie indexes on which the Exchange lists options and also clarifies the method for determining the exercise settlement value for certain option contracts that are based on the Nasdaq 100 Index, the Exchange believes that the proposed rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act,¹¹ in that it is designed 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.

B. Self-Regulatory Organization's Statement on Burden on Competition

This proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

⁹ Id.

¹⁰ Telephone conversation between Terri Evans, Special Counsel, Division of Market Regulation, Commission, and James Flynn, Attorney, CBOE, on June 10, 2005 (changing reference from Interpretation and Policy .12 to Rule 24.9(a)(4).

¹¹ 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

The CBOE neither solicited nor received comments with respect to the proposed rule change.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2005-26 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2005-26. 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. 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-2005-26 and should be submitted on or before [insert date 21 days after the date of publication in the Federal Register].

IV. Commission Findings and Order Granting Accelerated Approval of Proposed Rule change

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹² In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,¹³ which requires, in part, that the rules of an exchange be designed 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 the proposed rule change reflects the change in methodology for calculating the index settlement value of the Nasdaq 100 Index and clarifies that the settlement values of A.M. settled index options may be determined using an opening price other than the first reported sale.

¹² In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78f(b)(5).

The Commission finds good cause for accelerating approval of the proposed rule change, as amended, prior to the thirtieth day after publication in the Federal Register.

The Commission notes that accelerating approval of the proposed rule change will allow the Exchange to timely reflect in its rules the manner in which Nasdaq proposes to calculate the current index value at expiration for the Nasdaq 100 Index starting with the June 2005 expiration. Accordingly, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,¹⁴ to approve the proposed rule change, as amended, on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change, as amended (File No. SR-CBOE-2005-26), be approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland
Deputy Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ Id.

¹⁶ 17 CFR 200.30-3(a)(12).