

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52313; File No. SR-CBOE-2005-41)

August 22, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Relating to the Elimination of Position and Exercise Limits on NDX Options

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 May 23, 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, II, and III below, which Items have been prepared by the CBOE. 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 Exchange proposes to amend its rules to eliminate position and exercise limits for options on the Nasdaq 100 Index (“NDX”). The text of the proposed rule change is available on the CBOE’s Web site ([www.cboe.com](http://www.cboe.com)), at the CBOE’s Office of the Secretary, and at the Commission’s Public Reference Room.

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 had received on the proposed rule change. The text of these statements may be examined at the places specified in

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Item IV 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 CBOE proposes to eliminate position and exercise limits for options on the NDX, a broad-based securities index. In November 2001, the Commission granted permanent approval to a CBOE pilot program that eliminated position and exercise limits for options on the S&P 500 Index (“SPX”), the S&P 100 Index (“OEX”), and the Dow Jones Industrial Average (“DJX”).<sup>3</sup> The Exchange believes that the circumstances and considerations relied upon in approving the elimination of position and exercise limits for options on those broad-based indexes equally apply to this proposal relating to NDX position and exercise limits.

In the Permanent Approval Order relating to SPX, OEX, and DJX options, the Commission cited several reasons for allowing the Exchange to eliminate position and exercise limits for these options. First, the Commission expressed its belief that the enormous capitalization of each index and the deep liquid markets for the securities underlying each index significantly reduced concerns of market manipulation or disruptions in the underlying markets.<sup>4</sup> The Commission previously had also noted the active trading volume for options on the

---

<sup>3</sup> See Securities Exchange Act Release No. 44994 (October 26, 2001), 66 FR 55722 (November 2, 2001) (order granting permanent approval to the elimination of position and exercise limits on the SPX, OEX, and DJX) (“Permanent Approval Order”). See also Securities Exchange Act Release No. 40969 (January 22, 1999), 64 FR 4911 (February 1, 1999) (order approving the original pilot program) (“Pilot Approval Order”).

<sup>4</sup> See Permanent Approval Order, supra note 3.

respective indexes.<sup>5</sup> The CBOE believes that NDX shares these factors in common with the SPX, OEX, and DJX. As of the date of this rule filing, the approximate market capitalizations of the SPX, OEX, and DJX were \$10.97 trillion, \$5.94 trillion, and \$3.7 trillion, respectively. The average daily trading volumes (“ADTVs”) for all underlying components of the indexes were 1,250, 560, and 250 million shares, respectively, and the ADTV for options on the indexes were 253,981 contracts, 72,809 contracts, and 30,938 contracts, respectively.<sup>6</sup> The CBOE believes that the NDX has very comparable characteristics. The market capitalization for the NDX is \$1.84 trillion dollars, the ADTV for the underlying securities is 420 million shares, and the options ADTV is 44,008 contracts.

Secondly, with respect to SPX, OEX, and DJX options, the Commission noted that the financial requirements imposed by both the Exchange and the Commission help to address concerns that a CBOE member or its customer(s) may try to maintain an inordinately large unhedged position in the indexes.<sup>7</sup> These identical financial requirements also apply to NDX options. Under CBOE rules, the Exchange has the authority to impose additional margin upon accounts maintaining underhedged positions, and is further able to monitor accounts to determine when such action is warranted. As noted in the Exchange’s rules, the clearing firm carrying such an account would be subject to capital charges under Rule 15c3-1 under the Act<sup>8</sup> to

---

<sup>5</sup> See Pilot Approval Order, supra note 3.

<sup>6</sup> ADTVs are calculated over the previous three months of trading.

<sup>7</sup> See Permanent Approval Order, supra note 3.

<sup>8</sup> 17 CFR 240.15c3-1.

the extent of any resulting margin deficiency.<sup>9</sup>

Finally, the Exchange believes that with regard to SPX, OEX, and DJX options, the Commission relied substantially on the Exchange's ability to provide surveillance and reporting safeguards to detect and deter trading abuses arising from the elimination of position and exercise limits in options on these indexes. The Exchange represents that it monitors trading in NDX options in much the same manner as trading in SPX, OEX, and DJX options and that the current CBOE surveillance procedures are more than adequate to continue monitoring NDX options. Additionally, the Exchange proposes to impose a reporting requirement on CBOE members (other than CBOE market-makers) and member organizations that trade NDX options. This reporting requirement, which is currently imposed on members and member organizations that trade SPX and OEX options, would require each member or member organization that maintains in excess of 100,000 NDX contracts on the same side of the market, for its own account or for the account of a customer, to report information as to whether the positions are hedged and provide documentation as to how such contracts are hedged, in a manner and form required by the Exchange's Department of Market Regulation.<sup>10</sup> The Exchange also may specify other reporting requirements, as well as the limit at which the reporting requirement may be triggered.<sup>11</sup>

In the interest of consistency, the Exchange also proposes to amend Exchange rules

---

<sup>9</sup> See Interpretation and Policy .04 to CBOE Rule 24.4. Clarified as per telephone conversation between Ira Brandriss, Special Counsel, and Theodore Venuti, Attorney, Division of Market Regulation, Commission, and James M. Flynn, Attorney II, Legal Division, CBOE, on August 12, 2005 ("Telephone Conversation of August 12, 2005").

<sup>10</sup> See Interpretation and Policy .03 to CBOE Rule 24.4.

<sup>11</sup> Id.

relating to the trading of FLEX broad-based index options to reflect that there shall be no exercise or position limits on NDX options and to adopt the 100,000 contract reporting requirement for NDX FLEX options.<sup>12</sup> Thus, the provisions in CBOE Rule 24A.7(b) applicable specifically to SPX and OEX FLEX options shall also apply to NDX FLEX options.<sup>13</sup>

The Exchange believes that eliminating position and exercise limits for NDX options and FLEX options is consistent with CBOE Rules relating to similar broad-based indexes and also allows CBOE members and their customers greater hedging and investment opportunities.

## 2. Statutory Basis

By placing position and exercise limits for NDX options on an equal basis with other similar broad-based index options, the Exchange believes that this proposed rule change is consistent with Section 6(b) of the Act,<sup>14</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>15</sup> in particular, in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.

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

The CBOE believes that the proposed rule change would not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

---

<sup>12</sup> See CBOE Rules 24A.7 and 24A.8. The text of Rule 24A.8 is not amended by this proposed rule change.

<sup>13</sup> This would include the authority of the Exchange to impose additional margin on accounts maintaining underhedged positions in these options. Telephone Conversation of August 12, 2005, supra note 9.

<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 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

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 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the CBOE consents, the Commission will:

- (A) by order approve 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2005-41 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-2005-41. 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, 100 F Street, NE, 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 publicly available. All submissions

should refer to File Number SR-CBOE-2005-41 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>16</sup>

Margaret H. McFarland  
Deputy Secretary

---

<sup>16</sup> 17 CFR 200.30-3(a)(12).