

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52562; File No. SR-CBOE-2004-37)

October 4, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to the Deletion of Interpretation and Policy .01(e) to CBOE Rule 5.4

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 1, 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 CBOE. On September 21, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</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 Exchange proposes to eliminate an Interpretation and Policy to a CBOE Rule concerning the approval of securities that underlie options traded on the Exchange. The text of the proposed rule change is available on 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.

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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> See Form 19b-4 dated September 21, 2005 (“Amendment No. 1”). In Amendment No. 1, which replaced the original filing in its entirety, the Exchange conformed the definition of “NMS security” in CBOE Rules 5.3(a)(1) and Interpretation .01(f) of Rule 5.4 to that found in Regulation NMS. See Securities Exchange Act Release No. 51808 (June 9, 2005) 70 FR 37496 (June 29, 2005).

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 these statements may be examined at the places specified in 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 Exchange proposes to eliminate subparagraph (e) of Interpretation .01 (hereafter, "Interpretation .01(e)") to CBOE Rule 5.4. Interpretation .01 to Rule 5.4 sets forth various situations under which an underlying security previously approved for Exchange option transactions will no longer meet Exchange requirements for the continuance of such approval ("continued listing criteria"). Rule 5.4 provides that the Exchange will not open for trading any additional series of options in that class and may also limit any new opening transactions in those option series that have already been opened. The Exchange also proposes to amend certain provisions of Exchange rules that govern the criteria for both the (1) initial listing and (2) the continued approval to list options on certain securities, as provided under Rule 5.3(a)(1) and Interpretation and Policy .01(f) to Rule 5.4.

Currently, Interpretation .01(e) provides that an underlying security will no longer be approved for CBOE options transactions when:

"(e) the issuer has failed to make timely reports as required by applicable requirements of . . . [the Act], and such failure has not been corrected within 30 days after the date the report was due to be filed."

The Exchange proposes to eliminate this provision because the Exchange states that (1) it limits investors' ability to use options to hedge existing equity positions, and (2) it is not necessary in the context of the rest of Interpretation .01 to Rule 5.4.

The Exchange contends that Interpretation .01(e) prevents investors from using new option series to hedge positions they may hold in the underlying security of companies that fail to make timely reports required by the Exchange Act.<sup>4</sup> The Exchange states that this restriction is not consistent with the rules and regulations in the markets for the underlying securities where failure to file reports required by the Exchange Act does not result in a similar trading restriction. Accordingly, the Exchange maintains that Interpretation .01(e) limits the abilities of shareholders in such companies who may wish to hedge their positions with new option series, at a time when the ability to hedge may be particularly important.

The Exchange believes that this provision may have been appropriate when first implemented around 1976 when the listing and trading of standardized options on exchanges was still in its infancy, and information pertaining to the operational soundness of public companies was not readily available to the investing public. However, the Exchange states that the listed options market is now a mature market with sophisticated investors with significant access to information to assist them in making informed investment decisions, such as information on a company's timely filing

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<sup>4</sup> The types of reports typically include both 10-K annual reports and 10-Q quarterly reports.

of Exchange Act reports.<sup>5</sup> The Exchange concludes that there is no reason to continue limiting investors' ability to execute transactions in options classes (including new series within those classes) simply because a company is not timely in filing its Exchange Act reports when investors are not similarly restricted from purchasing or selling shares in the underlying company.

Moreover, the Exchange has found that Interpretation .01(e) limits investors' ability to hedge underlying stock positions at a time when they may be in most need to protect their investment. The failure of a public company to comply with its reporting requirements under the Exchange Act could cause a significant movement in the price of the company's stock. Restricting the Exchange from opening new option series may leave investors with no means to hedge their positions with option contracts at strike prices that more accurately reflect the contemporaneous price trends of the underlying stock.

Additionally, the Exchange maintains that there is a more appropriate means to protect investors from trading options on potentially unstable securities. Existing Interpretation and Policy .01(f) to Rule 5.4 ("Interpretation .01(f)") provides that an underlying security will no longer be approved for the listing of new option series when:

“(f) The issue, in the case of an underlying security that is principally traded on a national securities exchange, is delisted from trading on that exchange and neither meets NMS criteria nor is traded through the facilities of a national securities association, or the issue, in the case of an underlying security that is principally traded through the facilities of a national securities association, is no longer designated as an NMS security.”

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<sup>5</sup> Despite this vastly improved degree of information education, it is still the responsibility of the CBOE to insure that no new options series is listed on an ineligible class.

The Exchange acknowledges that new options series on a security should not be permitted to be opened if the underlying security is no longer trading in its primary listing market. Typically, the Exchange becomes aware of issues that may impact the continued listing of a security on its primary listing exchange (or Nasdaq) well before the primary listing exchange delists that security. Exchange staff routinely monitor the daily press and informational releases disseminated by the primary listing exchanges and Nasdaq and also utilize private news services to monitor the news items pertaining to the issuers of securities that underlie options traded on the Exchange.<sup>6</sup> In many cases, when an issuer is delinquent in its Exchange Act reporting obligations, the issuer is given a substantial amount of time in which to comply before the listing market actually delists the issuer's security. In many situations, the issuer is able to comply with its reporting obligations without being delisted. During this period, CBOE states that its staff is continually monitoring the status of the issuers' compliance with reporting obligations to determine whether the security may be delisted.<sup>7</sup> Finally, the listing exchange or Nasdaq typically issue a press release well in advance of any delisting to give investors and other market participants ample notice.<sup>8</sup>

Given the availability of information relating to public issuers of securities in today's markets, and in light of additional continued listing standards under Rule 5.4, the

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<sup>6</sup> This is consistent with Interpretation .03 to Rule 5.4.

<sup>7</sup> Additionally, if the underlying security has been halted or suspended in the primary market, then the Exchange may halt trading in the option class pursuant to CBOE Rule 6.3(a) and shall halt such trading pursuant to CBOE Rule 6.3B. Telephone conversation between Jim Flynn, Attorney, CBOE, and Florence Harmon, Senior Special Counsel, Division of Market Regulation, Commission, October 3, 2005.

<sup>8</sup> The Commission posts delisting notices (or orders) on its Web site. [See www.sec.gov/rules/delist.shtml](http://www.sec.gov/rules/delist.shtml).

Exchange maintains that the appropriate point at which to restrict the issuance of new options series in an options class is when the security is delisted. Therefore, the Exchange proposes to eliminate Interpretation .01(e).

Finally, as a matter of “housekeeping,” the Exchange also proposes to clarify Exchange Rule 5.3(a)(1) and Interpretation .01(f), which govern the criteria for the initial and continued listing of options on a particular security. Both of these provisions include a requirement that the underlying security must be a national market system security (“NMS security”). As part of the recently adopted Regulation NMS, among other things, the Commission revised the definition of an “NMS security.”<sup>9</sup> Specifically, Rule 600(b)(46) under Regulation NMS defines an NMS security as “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.” Rule 600(b)(47) also defines an “NMS stock” as any NMS security other than an option. As such, Exchange Rule 5.3(a)(1) and Interpretation .01 (f) will be amended to reflect these new terms.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,<sup>10</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>11</sup> in particular, in that the proposed rule change will serve to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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<sup>9</sup> See Securities Exchange Act Release No. 34-51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

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.

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 self-regulatory organization 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, 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-37 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-CBOE-2004-37. 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 Room. 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-2004-37 and should be submitted by [insert date 21 days after the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Jonathan G. Katz  
Secretary

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