CBOE
CHICAGO BOARD OPTIONS EXCHANGE

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The Honorable Mary Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Gary Gensler
Chairman
Commodities Futures Trading Commission
Three Lafayette Centre 1155 21st Street, NW
Washington, DC 20581

RE: Supplemental Response to June 22, 2010 Meeting of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues

Dear Chairman Schapiro and Chairman Gensler:

On behalf of the Chicago Board Options Exchange, Incorporated, I am submitting the following supplemental response to the questions asked of the exchange panel by Chairman Gensler at the Joint SEC-CFTC Advisory Committee open meeting held on June 22, 2010.

We understand the need to reevaluate and potentially enhance the market-wide circuit breaker procedures in light of May 6. Whatever potential changes may be considered, it is of upmost importance that a measured and coordinated approach be taken among the stock, options and futures markets in formulating any new industry standards for addressing extreme volatility scenarios such as May 6. As the SEC has observed, today's markets are widely dispersed with securities often trading on multiple markets and closely related products trading on different markets. For example, today the markets can trade various ETF, option and future products based on the same broad-based index, such as the S&P 500, Dow Jones Industrial Average ("DJIA"), Nasdaq 100 or the Russell 2000. These are among the most closely watched indices that track stock market activity. The significant trading volume across markets and in related broad-based index products necessitates effective and efficient cross-market coordination.

Market-Wide Circuit Breakers

In considering what should be the benchmark for triggering a market-wide circuit breaker, we believe the S&P 500 would be an appropriate choice. The index is well-established, widely-published, and includes stocks of large publicly held companies that trade on either NYSE or Nasdaq. It is far broader and more representative of the U.S. equity markets than the DJIA. Also, as indicated above, many of the most active ETFs, options and futures, as well as other funds, track the S&P 500. The index is the leading benchmark for institutional investors, and the index products are also popular tools for retail investors. Institutional and retail investors have used products based on the S&P 500 for a variety of purposes over the years, including for investing, hedging, asset allocation and risk management, which should make its use as a benchmark easy to understand. Additionally, we note that the CBOE Volatility Index (VIX), a key measure of market expectations on near-term volatility, is based on S&P 500 stock index option prices.

We do not believe that the choice of the specific benchmark index used for determining a market-wide circuit breaker was relevant to the causes of the extreme market volatility that was experienced on May 6. Neither DJIA nor the S&P 500 would have triggered a market-wide circuit breaker under the current parameters that day. However, in looking at potential enhancements to the existing market-wide circuit breakers, we believe the S&P 500 should be the preferred benchmark considering the various factors noted above, that it is more representative of market performance because it is based on 500 securities (versus the DJIA's 30 stocks), its computation method is market-value weighted (versus the Dow's price-weighted average method), and it is the benchmark for the most liquid ETF, option and future products.

We continue to believe that the market-wide circuit breakers should be triggered based on a percentage decline in the benchmark index and not based on velocity or another measure. The percentage decline methodology is easy to understand and only captures instances of extreme, market-wide volatility. The individual stock circuit breakers, which pause trading based on market moves up or down over a rolling 5-minute period, are designed to identify instances of extreme volatility in a particular security. To modify the market-wide circuit breaker to do the same would be duplicative, overly complex and unnecessary to achieve the intended goals of a market-wide circuit breaker. That said, we do believe the parameters for triggering a market-wide circuit breaker could be updated in light of May 6 and to reflect advances in trading technologies and simplify the process.

Currently, all stock, option, and future markets halt if the DJIA reaches Level 1, 2 or 3 below its closing value on the previous trading day. Levels 1, 2 and 3 are calculated at the beginning of each calendar quarter, using the average closing value of the DJIA for the prior month. Level 1 is 10% of the average closing value calculation, Level 2 is 20%, and Level 3 is 30%, with each Level rounded to the nearest fifty points. If Level 1 is reached before 2 pm (all times noted herein are Eastern Time), trading halts for one hour. If Level 1 is reached at or after 2 pm but before 2:30, trading halts for 30 minutes. If

Level 2 is reached before 1 pm, trading halts for two hours. If Level 2 is reached at or after 1:00 pm but before 2 pm, trading halts for one hour. If Level 2 is reached at or after 2 pm, trading halts for the remainder of the day. If Level 3 is reached, trading halts for the remainder of the day.

We believe the market-wide circuit breaker parameters should be modified as follows: First, rather than re-balancing the Levels on a quarterly basis using the prior month's average close, the Levels should just be calculated daily based on the prior day's close. This change will simplify the calculation, eliminate the need for quarterly updates, and more accurately reflect the current state of the market on any given day. Second, rather than using 10%, 20% and 30%, the Levels should be reduced to 5%, 10% and 20%. While these levels would increase the likelihood of being triggered, they more accurately represent those instances of extreme, market-wide volatility that the circuit breaker is designed to address. For example, these percentages would have resulted in a market-wide halt of trading on May 6, which we believe would have been appropriate for that day. Third, the halts should simply last 10 minutes if Level 1 is reached before 3:30 pm, 30 minutes if Level 2 is reached before 3:15 pm and for the remainder of the day if Level 2 is reached at or after 3:15 pm, and for the remainder of the day if Level 3 is reached at any point throughout the day. This change would simplify the process and, recognizing the advances in technology and market efficiencies, would allow for trading to resume sooner, which we believe is generally in the best interest of the investors. This change also continues to favor keeping or getting markets open before the close.

Other Considerations

The joint SEC-CFTC preliminary report identifies several areas to be reviewed in light of May 6. Besides market-wide circuit breakers, individual stock halts or "pauses" and clearly erroneous policies are being considered and subjected to pilot programs through December 2010. Limit up/limit down collars, LRP and self-help protocols, stop loss and market orders, stub quotes and market maker obligations have also been identified for further exploration.

As I stated during the panel discussion, we caution the Committee that we simply cannot predict the nature of the next market-wide "crisis" that comes our way. We should not make sweeping changes to our current operations on an expedited basis simply for change sake or because a particular trading practice has been identified for review following May 6. Our nuanced and intricate market structure has evolved over many years in reaction to numerous events and concerns. We need time to fully analyze how events transpired and how we can improve the chances of mitigating potential disruptions while understanding that we cannot forecast every future problem. We should carefully consider our existing infrastructure. We should appreciate that any incremental change that may ultimately be implemented – such as the imposition of individual stock pauses – impacts other areas, both good and bad, and may go a long way toward negating the need for further changes. We also should be mindful of unintended consequences and added costs that may occur from imposing complicated, burdensome and unnecessary changes, especially in conjunction with several other market changes that the SEC and CFTC have proposed. We should ensure that any rules-based solutions continue to have sufficient flexibility so that markets are able to react appropriately and do what is right for investors when they are faced with inequitable outcomes as a result of unanticipated market disruptions or complications.

Moving forward, there must be coordination among the stock, option and futures markets, the SEC and the CFTC in analyzing matters that may have market-wide implications, such as market-wide halts and individual stock pauses in broad-based ETFs. We recognize the possibility of a disconnect between market-wide halt standards and the proposed introduction of individual stock pauses in broad-based ETFs that are related index options and futures. We look forward to the continued discussions on this topic. Beyond examining market-wide halt parameters and individual stock pauses, the SEC and CFTC should proceed cautiously with undertaking any further changes in connection with May 6. It is essential that we examine these two areas and, in particular, allow the existing individual stock pause pilot to be completely rolled out and operational for some period of time before considering other changes. Our efforts should be focused on enhancing the pilot. For example, we should consider solutions for preventing erroneous pauses from occurring, such as triggering a pause only if there are prints on two or more markets below the 10% level during the same rolling 5 minute period.

We do not believe it is necessary to introduce industry limit up or limit down collars on a market-wide or individual stock basis, as these sorts of practices involve substantial programming, restrict what could be valid market pricing and introduce complications for derivatives markets. With the options markets in particular, we are concerned about transparency and the certainty of being open or closed. Additionally, while we fully appreciate and understand the need for individual markets to innovate and offer their own competitive alternatives, we should be mindful of coordination and cross-market issues that may arise while there is a pilot ongoing that examines market-wide standards for trading pauses. Significant change has already been introduced in reaction to May 6 on a semi-emergency basis. We should figure out if it is working before making more substantial changes. These areas should be carefully explored, especially taking into account cross-market impacts, efficiency and effectiveness.

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CBOE appreciates the opportunity to comment and look forward to participating in the ongoing review of May 6. Should you have any questions on the issues discussed in this letter, please contact me at 312-786-7310.

Sincerely,

Edward J. Joyce

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President & Chief Operating Officer