SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60271; File No. SR-CBOE-2009-039)

July 9, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule Change and Amendment No. 1 Thereto to Extend the Delta Hedging Exemption From Equity Options Position Limits to Customers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on June 19, 2009, the Chicago Board Options Exchange, Incorporated ("Exchange" or "CBOE") 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 Exchange. On July 8, 2009, CBOE filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

CBOE proposes to amend Interpretation and Policy .04 to Rule 4.11 to extend the delta hedging exemption from equity option position limits to customers whose accounts are carried by a member and who use the pricing model maintained and operated by The Options Clearing Corporation ("OCC"). Although the proposed rule change would not amend the text of Rule 4.12, the proposed change would impact that rule because Rule 4.12 establishes exercise limits for an option at the same level as the option's position limit under Rule 4.11. The text of the rule proposal is available on the Exchange's website (http://www.cboe.org/legal), at the Exchange's Office of the Secretary and at the Commission.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

II. <u>Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change</u>

In its filing with the Commission, the self-regulatory organization 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 parts of such statements.

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

1. <u>Purpose</u>

On December 14, 2007, the SEC approved CBOE's rule proposal to create a delta-based equity hedging exemption from equity options (stock options and options on exchange-traded funds) position limits ("Exemption").[3] Unlike traditional equity hedging, which requires a one-to-one hedge, delta hedging varies the number of shares of the underlying security used to hedge an options position based on the relative sensitivity of the value of the option contract to a change in the price of the underlying security. For example, a stock option contract with a delta of .5 will move 50¢ for every $1.00 move in the underlying stock.

The Exemption currently only permits members or non-member affiliates of a member that use a "permitted pricing model" (as defined in Rule 4.11.04(c)(C)) to use the Exemption. The purpose of this filing is to extend the existing Exemption from equity option position limits to customers who use the pricing model maintained and operated by OCC.

In support of this proposal, the Exchange states that the Exchange considered including customers when the scope of the original filing to create the Exemption was being contemplated.

3 <u>See</u> Securities Exchange Act Release No. 34-56970 (December 14, 2007), 72 FR 72428 (December 20, 2007) (SR-CBOE-2007-99).

However, based on industry discussions, it was determined that a delta hedging exemption for customers would be proposed and phased in at a later time. Since the adoption of the Exemption over 18 months ago, customers have continued to express interest and have repeatedly requested that the Exchange seek to extend the Exemption to customers. During the time period during which the Exemption has been in effect, the Exchange has not encountered any problems and believes that the Exemption has been a useful tool for members and non-member affiliates. The Exchange believes that it is appropriate to extend the Exemption to customers after observing the positive and useful benefit it has had for members and non-member affiliates.

The Exchange believes that extending the Exemption to customers in the current market environment is particularly relevant as the Exchange has seen a trending of customers holding positions overlying lower priced securities bumping up against current position limits. Extending the Exemption to customers would provide relief to these customers by recognizing this widely accepted method for risk management and would not result in an increase to their overall notational exposure.

To affect the extension of the Exemption from equity options position limits to customers, the Exchange proposes to layer the term “customer” into the existing rule and proposes to codify separately the obligations of a customer using the Exemption. One key difference between members (and non-member affiliates) and customers using the Exemption would be that customers may only hedge their positions in accordance with the OCC pricing model.[4] Below, the Exchange will specify and describe how the existing Exemption rules will

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4 Other permitted pricing models includes ones used by (i) a member or its affiliate subject to consolidated supervision by the SEC pursuant to Appendix E of SEC Rule 15c3-1; (ii) a financial holding company ("FHC") or a company treated as an FHC under the Bank Holding Company Act of 1956, or its affiliate subject to consolidated holding company group supervision; (iii) an SEC registered OTC derivatives dealer; and (iv) a national

apply to customers.

Delta Neutral-Based Equity Hedge Exemption

The Exchange proposes to extend the existing Exemption from equity options position and exercise limits[5] to positions held by customers that are "delta neutral." Rule 4.11.04(c)(A) currently provides that the term "delta neutral" refers to an equity option position that is hedged in accordance with a permitted pricing model by a position in the underlying security or one or more instruments relating to the underlying security, for the purpose of offsetting the risk that the value of the option position will change with incremental changes in the price of the security underlying the option position. The Exchange is proposed to amend the existing definition of the term "delta neutral" by requiring that customers seeking to use the Exemption may only hedge their positions in accordance with the pricing model maintained and operated by The Options Clearing Corporation ("OCC Model").

Any equity option position that is not delta neutral would be subject to position and exercise limits, subject to the availability of other exemptions. Only the "option contract equivalent of the net delta" of such position would be subject to the appropriate position limit.[6]

Only financial instruments relating to the security underlying an equity options position are included in any determination of an equity options position's net delta or whether the options

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bank. Customers seeking to use the Exemption are not permitted to hedge their positions in accordance with these models.

5 Exchange Rule 4.12 establishes exercise limits for an option at the same level as the option's position limit under Rule 4.11, therefore no changes are proposed to Rule 4.12.

6 Under Rule 4.11.04(c)(B), the term "options contract equivalent of the net delta" is defined as the net delta divided by the number of shares underlying the option contract, and the term "net delta" is defined as, at any time, the number of shares (either long or short) required to offset the risk that the value of an equity option position will change with incremental changes in the price of the security underlying the option position, as determined in accordance with a permitted pricing model (which will be limited to the OCC Model for customers).

position is delta neutral. In addition, (as with members) customers may not use the same equity or other financial instrument position in connection with more than one hedge exemption. Therefore, a stock position used as part of a delta hedging strategy could not also serve as the basis for any other equity hedge exemption.

Aggregation of Accounts

Rule 4.11.04(c)(D) sets forth the aggregation requirements[7] for those seeking to rely on the Exemption. The Exchange proposes to amend this rule so that it extends to customers. Specifically, those eligible to rely on the Exemption are required to ensure that the permitted pricing model (OCC Model only for customers) is applied to all positions in or relating to the security underlying the relevant options position that are owned or controlled by the member and it affiliates or customers.

However, the net delta of an option position held by an entity entitled to rely on the Exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in or relating to the security underlying the option position held by an affiliated entity or by another trading unit within the same entity, provided that: (i) the entity demonstrates to the Exchange's satisfaction that no control relationship, as defined in Rule 4.11.03, exists between such affiliates or trading units, and (ii) the entity has provided (by the

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7 Rules 4.11 and 4.12 require that positions maintained in accounts directly or indirectly controlled by the same individual or entity be aggregated for position and exercise limit purposes. Pursuant to Rule 4.11, control exists when an individual or entity makes investment decisions for an account or accounts, or materially influences directly or indirectly the actions of any person who makes investment decisions. Control is also presumed in the following circumstances: (a) among all participants of a joint account who have authority to act on behalf of the account; (b) among all general partners to a partnership account; (c) when an individual or entity holds an ownership interest of 10% or more in an entity, or shares in 10% or more of profits and/or losses of an account; (d) when accounts have common directors or management; and (e) where an individual or entity has authority to execute transactions in an account.

member carrying the account as applicable) the Exchange written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of the Exemption.

Any member, non-member affiliate or customer relying on the Exemption must designate, by prior written notice to the Exchange (to be obtained and provided by the member carrying the account as applicable), each trading unit or entity whose options positions are required by Exchange rules to be aggregated with the options positions of such member, non-member affiliate or customer relying on the Exemption for purposes of compliance with Exchange position or exercise limits.

Obligations of Member

The Exchange proposes to add new subparagraph (4) to Rule 4.11(c)(E) to set forth the obligations of a member carrying an account that includes an equity option position for a customer who intends to rely on the Exemption. Specifically, the member would be required to obtain from the customer a written certification to the Exchange that the customer is using the OCC Model. In addition, the member would be required to obtain from the customer a written statement confirming that such customer: (a) is relying on the Exemption; (b) will use only the OCC Model for purposes of calculating the net delta of the customer's option positions for purposes of the Exemption; (c) will promptly notify the member if the customer ceases to rely on the Exemption; and (d) in connection with using the OCC Model, has duly executed and delivered to the Exchange such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on the Exemption.

Reporting

The Exchange is not proposing to amend the existing rule text of Rule 4.11.04(c)(F). This is because the Exchange believes that the existing rule text would apply to members carrying customer accounts. Specifically, each member that holds or carries an account that relies on the Exemption shall report, in accordance with Rule 4.13,[8] (i) all equity option positions (including those that are delta neutral) that are reportable thereunder, and (ii) on its own behalf or on behalf of a designated aggregation unit pursuant to Rule 4.11.04(c)(D), for each such account that holds an equity option position subject to the Exemption in excess of the levels specified in Rule 4.11, the net delta and the options contract equivalent of the net delta of such position.

Records

The Exchange proposes to amend existing Rule 4.11.04(c)(G) governing records so that it extends to members carrying customer accounts. Specifically, each member relying on the Exemption would be required to (i) retain, and would be required to undertake reasonable efforts to ensure that any non-member affiliate of the member or customer relying on the Exemption retains, a list of the options, securities and other instruments underlying each options position net delta calculation reported to the Exchange hereunder, and (ii) produce such information to the Exchange upon request.

Clarifying Minor Revisions to Existing Rule Text

The Exchange is taking this opportunity to propose certain minor changes to the existing text of Rule 4.11.04(c) to clarify that the affirmative obligations codified in connection with

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8 Exchange Rule 4.13 requires, among other things, that members report to the Exchange aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of options contracts dealt in on the Exchange.

relying on the Exemption belong to members. For example, any written documentation required to be provided to the Exchange in connection with the Exemption must be provided by the member relying on the Exemption or provided by the member who carries the account of a non-member affiliate or customer relying on the Exemption. The Exchange states that all communications regarding reliance on the Exemption by non-member affiliates or customers will be had with the member carrying such accounts and not with such non-member affiliates or customers.

The Exchange will not implement a delta-based equity hedge exemption for customers until it provides a representation to the Office of Compliance Inspections and Examinations ("OCIE") that it can adequately surveill for such an exemption.[9]

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act[10] and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.[11] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[12] requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange believes that extension of the Exemption from equity options and exercise limits to customers is appropriate in that it is based on a widely accepted risk management method used in options trading.

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9 See Amendment No. 1 to the proposed rule change.

10 15 U.S.C. 78s(b)(1).

11 15 U.S.C. 78f(b).

12 15 U.S.C. 78f(b)(5).

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 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

The Exchange neither solicited nor received comments on the proposal.

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 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-2009-039 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2009-039. 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, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-2009-039 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[13]

Elizabeth M. Murphy
Secretary

[13] 17 CFR 200.30-3(a)(12).