

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62870; File No. SR-CBOE-2010-078)

September 8, 2010

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Permit Certain FLEX Options to Trade under the FLEX Trading Procedures for a Limited Time on a Closing Only Basis

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 30, 2010, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. 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 is proposing to amend certain CBOE rules pertaining to Flexible Exchange (“FLEX”) Options to permit certain FLEX Options to continue to trade under the FLEX trading procedures for a limited time. The text of the proposed rule change is available on the Exchange’s website (www.cboe.org/Legal), on the Commission’s website at <http://www.sec.gov>; at the Exchange’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 self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this filing is to allow certain FLEX Options, which are identical in all terms to a Non-FLEX Option, to continue to trade using the FLEX trading procedures for the balance of the trading day on which the Non-FLEX Option is added as an intra-day add.

The Exchange recently adopted rule changes to allow FLEX Options to expire on or within two business days of a third-Friday-of-the-month expiration ("Expiration FLEX Options").³ Such FLEX Options could have either an American-, European-, or European-Capped-style exercise. Among other things, the rule change also provided that Expiration FLEX Options will be permitted before (but not after) Non-FLEX Options with identical terms are listed. Once and if an option series is listed for trading as a Non-FLEX Option series, (i) all existing open positions established under the FLEX trading procedures shall be fully fungible with transactions in the respective Non-FLEX Option series, and (ii) any further trading in the series would be as Non-FLEX Options subject to the Non-FLEX trading procedures and rules.

The Options Clearing Corporation ("OCC") became concerned that, in certain circumstances, in the event a Non-FLEX Option is listed with identical terms to an existing FLEX Option, OCC could not net the positions in the contracts until the next business day. If the Non-FLEX Option were listed intra-day, and an investor with a position in the FLEX Option

³ See Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (SR-CBOE-2008-115).

attempted to close the position using the Non-FLEX Option, the investor would be technically long in one contract and short in the other contract. This would expose the investor to assignment risk until the next day despite having offsetting positions.

The limited circumstances are:

- The Non-FLEX Option is listed intra-day.
- The FLEX contract is for American-style exercise.
- All other terms are identical and the contracts are otherwise fungible.

The risk does not occur in expiration Friday FLEX Option positions during the five days prior to expiration, as no new Non-FLEX Option series may be listed within five days of expiration. It also does not exist for FLEX Option positions that will be identical to Non-FLEX series to be added after expiration, as those new series are added “overnight” and OCC will convert the FLEX position to the Non-FLEX Option series at the time the Non-FLEX series is created. In addition, it does not exist for FLEX Options positions that have a European-Capped-style exercise, as there are no Non-FLEX European-Capped-style options currently traded on CBOE. Further, it does not exist for most FLEX Index Options listed on CBOE, as most Non-FLEX Index options currently traded on CBOE are European-style exercise, and thus the Non-FLEX Index Options cannot be exercised on the day the series is listed. The only exception is Non-FLEX, American-style options on the S&P 100 (OEX).

As an example, suppose underlying issue XYZ, trading around \$25 per share, has options listed on the March cycle, and in February an investor wishes to buy just-out-of-the-money call options that expire in May. Since the Non-FLEX May Options will not be listed until after the March expiration, the investor enters a FLEX Option order in February to buy 250 Call 30 options expiring on the third Friday of May. If, as expected, the Non-FLEX May 30 call options

are listed on the Monday after March expiration, the investor's open FLEX position will be converted by OCC over the weekend following March expiration to the Non-FLEX series.

However, if XYZ stock should decline between the time of the FLEX transaction and March expiration, the May 30 calls may not be added after March expiration. If that were to occur, the May 30 calls may be added sometime later. Suppose the Exchange receives a request to add the May 30 calls on the morning of the Wednesday after expiration, and the Exchange lists them immediately. The investor with the FLEX position may then decide it is an opportune time to close his position.

Under the current rules, the investor would be required to close the position by entering a sell order in the new Non-FLEX Option series. However, when the Non-FLEX transaction is reported to OCC, the investor is considered short in the Non-FLEX Option series, and is still long in the FLEX Option. OCC cannot aggregate the FLEX positions into the Non-FLEX series until after exercise and assignment processing. If a buyer in the new Non-FLEX series were to exercise the options, the original investor who had attempted to close the FLEX position with an offsetting Non-FLEX trade would be at risk of being assigned on the technically short Non-FLEX position.

Because of this risk, OCC will not clear an American-style expiration Friday FLEX option. The Exchange has spoken with OCC and OCC has agreed that allowing an option position in a FLEX contract to be closed using a FLEX Option in such circumstances will mitigate the risk.

The assignment risk does not exist if the Non-FLEX Option is to be added the next trading day. In situations where OCC is aware that a series will be added overnight, they can convert the FLEX position to a Non-FLEX position before the next trading day. However, OCC

cannot guarantee that an identical Non-FLEX series will not be added intra-day, and thus will not clear such American-style FLEX Options.

CBOE is proposing a limited exception to the requirement that the trading in such options be under the Non-FLEX trading procedures. The Exchange proposes that, in the event a Non-FLEX Option is listed intra-day, a FLEX Option position with identical terms could be closed under the FLEX trading procedures, but only for the balance of the trading day on which the series is added. Under the proposed rule change, both sides of the FLEX transaction would have to be closing only positions.

This change will allow a FLEX Option to be traded in such a manner to mitigate assignment risk.

A FLEX Post Official (also referred to in the rules as simply a “FLEX Official”)⁴ has the regulatory responsibility for reviewing the conformity of FLEX trades to the terms and specifications contained in Rule 24A.4 or 24B.4, as applicable. In the event a Non-FLEX series, having the same terms as an existing expiration Friday FLEX Option, is listed intra-day, the FLEX Official will review any subsequent FLEX transactions in that series and verify that the transaction is being executed for the purpose of closing out an existing FLEX position. In addition:

- With respect to FLEX trades occurring on the Chapter XXIVA FLEX trading platform, should such trading platform be used by the Exchange,⁵ the FLEX Official will not disseminate a FLEX Request for Quote for any order representing a FLEX

⁴ FLEX Officials are Exchange employees or independent contractors designated pursuant to Rule 24A.12 or 24B.14.

⁵ Currently CBOE’s Chapter XXIVA FLEX trading platform is not utilized by the Exchange. Instead, all FLEX Options are currently traded on CBOE’s Chapter XXIVB FLEX trading platform.

series having the same terms as a Non-FLEX series, unless such FLEX Order is a closing order (and it is the day the Non-FLEX series has been added). Additionally, if the FLEX Official were to disseminate a FLEX Request for Quotes for a closing order representing a FLEX series having the same terms as a Non-FLEX series, the FLEX Official would only accept response quotes and orders that were closing out an existing FLEX position.

- With respect to FLEX trades occurring on the Chapter XXIVB FLEX trading platform, the FLEX Official will make an announcement that the FLEX series is now restricted to closing transactions; a FLEX Request for Quotes may not be disseminated for any order representing a FLEX series having the same terms as a Non-FLEX series, unless such FLEX Order is a closing order (and it is the day the Non-FLEX series has been added); and only responses that were closing out an existing FLEX position would be permitted. Any transactions that occur that do not conform to these requirements would be nullified by the FLEX Official pursuant to Rule 24B.14.

The CBOE Department of Regulation reviews FLEX trading activity, and, in the event a Non-FLEX series with the same terms as an expiration Friday FLEX option is listed intra-day, will review any subsequent FLEX transactions in the series to verify that they are closing a position.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act⁶ and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.⁷

⁶ 15 U.S.C. 78s(b)(1).

Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁸ in that it is 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, by giving CBOE Trading Permit Holders and investors additional tools to trade customized options in an exchange environment while allowing a FLEX position to be traded in such a manner as to mitigate inadvertent assignment risk.

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

Because the foregoing rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁹ and Rule 19b-4(f)(6) thereunder.¹⁰

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of the filing. However, pursuant to Rule 19b-4(f)(6)(iii),¹¹ the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing.

The Commission notes that the proposed rule change is substantially similar to a proposed rule change previously submitted by NYSE Arca which was published for notice and comment in the Federal Register.¹² The Commission notes that it did not receive any comments on the NYSE Arca proposal, and does not believe the CBOE's proposal raises any new or novel issues. Further, as noted above, because of the inadvertent assignment risk, market participants could not trade previously approved American style FLEX Options expiring on Expiration Friday.¹³ The proposal seeks to mitigate such assignment risks by limiting certain FLEX transactions to closing only, thereby allowing the trading of previously approved FLEX Options. For these reasons, the Commission believes that waiver of the 30-day operative delay is

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the filing of the proposed rule change, or such shorter time as designated by the Commission. The Commission notes that the Exchange has satisfied this requirement.

¹¹ 17 CFR 240.19b-4(f)(6)(iii).

¹² See Securities Exchange Act Release No. 62321 (June 17, 2010), 75 FR 36130 (June 24, 2010) (SR-NYSEArca-2010-46).

¹³ See supra note 5.

consistent with the protection of investors and the public interest and therefore, designates the proposed rule change operative upon filing.¹⁴

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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-2010-078 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-2010-078. 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 website (<http://www.sec.gov/rules/sro.shtml>). Copies

¹⁴ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such 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 No. SR-CBOE-2010-078 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Elizabeth M. Murphy
Secretary

¹⁵ 17 CFR 200.30-3(a)(12).