

(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-2008-16 on the subject line.

Paper Comments

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

All submissions should refer to File Number SR-CBOE-2008-16. 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, 100 F Street, NE., Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. 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-2008-16 and should be submitted on or before June 20, 2008.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁹

J. Lynn Taylor,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57850; File No. SR-CBOE-2006-105]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, Regarding the Listing and Trading of Binary Options on Broad-Based Security Indexes

May 22, 2008.

I. Introduction

On December 29, 2006, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade binary options on broad-based security indexes. The CBOE filed Amendment Nos. 1 and 2 to the proposal on September 6, 2007, and April 4, 2008,³ respectively. The proposed rule change, as modified by Amendment No. 2, was published for comment in the **Federal Register** on April 17, 2008.⁴ The Commission received no comments regarding the proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposal

A. Generally

The CBOE proposes to list and trade certain cash-settled, European-style binary options on broad-based security indexes. At expiration, an option listed pursuant to this proposal would pay an exercise settlement amount equal to the exercise settlement value multiplied by the contract multiplier.⁵ Unlike a traditional option, a binary option will

pay a fixed sum at expiration regardless of the magnitude of the difference between the settlement value and the option's exercise price. A call binary index option would pay out if the settlement value of the underlying index were at or above the option's exercise price at expiration, and a put binary index option would pay out if the underlying index were below the option's exercise price at expiration.⁶

The Exchange is proposing to add a new series of rules to Chapter XXII of its rulebook (which is currently "reserved") relating to binary options. Trading of binary options would also be subject to Chapters I through XIX, XXIV, XXIVA, and XXIVB, as supplemented by the new rules of Chapter XXII.

B. Listing Standards

Under the proposal, the Exchange may from time to time approve for listing and trading on the Exchange binary option contracts on a broad-based index⁷ which has been selected in accordance with CBOE Rule 24.2 and the Interpretations and Policies thereunder.⁸ After a particular binary option class has been approved for listing and trading on the Exchange, the Exchange may from time to time open for trading series of options on that class.⁹ The Exchange may add new series of options on the same class, as provided for in CBOE Rule 24.9 and the Interpretations and Policies thereunder. Additional series of the same binary option class may be opened for trading on the Exchange when the Exchange deems it necessary to maintain an orderly market or to meet customer demand.¹⁰ The maintenance listing standards for options on broad-based indexes set forth in CBOE Rule 24.2 and the Interpretations and Policies thereunder will be applicable to binary options on broad-based indexes.¹¹ Binary options form a separate class from other options overlying the same broad-based index.¹²

Binary options traded on the Exchange will be designated as to expiration date, exercise price, exercise settlement amount, contract multiplier, and underlying broad-based index.¹³ Binary index options will be a.m.-settled unless the traditional options on

⁹ 17 CFR 200.30-3(a)(12).

¹¹ 15 U.S.C. 78s(b)(1).

¹² 17 CFR 240.19b-4.

³ Amendment No. 2 replaces the original filing and Amendment No. 1 in their entirety.

⁴ See Securities Exchange Act Release No. 57642 (April 9, 2008), 73 FR 20985.

⁵ The exercise settlement value will be an amount determined by the CBOE on a class-by-class basis and will be equal to or between \$10 or \$1,000, unless otherwise adjusted pursuant to CBOE Rule 5.7. See CBOE Rule 22.1(e).

⁶ See CBOE Rules 22.1(b) and (c).

⁷ CBOE Rule 24.1(i)(1) defines a "broad-based index" as "an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries."

⁸ See CBOE Rule 22.3(a).

⁹ See CBOE Rule 22.3(c).

¹⁰ See CBOE Rule 22.3(d).

¹¹ See CBOE Rule 22.4.

¹² See CBOE Rule 22.3(a).

¹³ See CBOE Rule 22.3(b).

the same underlying index (*i.e.*, the S&P 100 Index (“OEX”)) are p.m.-settled.¹⁴ Under the proposal, binary options may expire from one day to 36 months from the time that they are listed.¹⁵

C. The Options Clearing Corporation

The Options Clearing Corporation (“OCC”) will issue, clear, and settle the binary options contemplated in this proposal. The OCC has amended its by-laws and rules to accommodate the listing and trading of binary options.¹⁶ In addition, the CBOE understands that the OCC will submit to the Commission a proposed supplement to the Options Disclosure Document required by Rule 9b-1 under the Act¹⁷ to incorporate binary options on broad-based security indexes.

D. Position and Exercise Limits and Position Reporting Requirements

The Exchange is adopting a two-pronged approach to determine position limits for binary options.¹⁸ In determining compliance with CBOE Rule 4.11, the Exchange proposes a fixed position limit of 15,000 contracts for binary options on a broad-based index for which traditional options on the same broad-based index have no position limit, provided that the exercise settlement amount is \$10,000.¹⁹ For binary options that have an exercise settlement amount that is not equal to \$10,000, the position limit will be 15,000 times the ratio of 10,000 to the exercise settlement amount (*e.g.*, if the binary option exercise settlement amount is \$1,000, then the position limit is 150,000 contracts. If the binary option exercise settlement amount is \$12,000, then the position limit is 12,500 contracts).²⁰

The Exchange is adopting a formulaic position limit for binary options on a broad-based index for which traditional options on the same broad-based index have a position limit.²¹ The formulaic position limit will be calculated in accordance with the following methodology: (1) Determine the Market Capitalization of the S&P 500 Index; (2) determine the Market Capitalization of the broad-based index underlying the binary option; and (3) calculate the Market Capitalization Ratio of the broad-based index underlying the

binary option to the Market Capitalization of the S&P 500 Index. The position limit for binary options subject to a formulaic limit with an exercise settlement amount of \$10,000 will be: (1) 10,000 contracts if the Market Capitalization Ratio is greater than or equal to 0.50; (2) 5,000 contracts if the Market Capitalization Ratio is less than 0.50 but greater than or equal to 0.25; or (3) 2,500 contracts if the Market Capitalization Ratio is less than 0.25 but greater than or equal to 0.10.²² The Exchange will seek Commission approval prior to establishing position limits for binary options on broad-based indexes that have a Market Capitalization Ratio that is less than 0.10.²³ For binary options that have an exercise settlement amount that is not equal to \$10,000, the position limit will be the ratio of 10,000 to the exercise settlement amount multiplied by the applicable formulaic limit.²⁴

CBOE Rule 22.6 also provides that positions in binary options on the same broad-based index that have different exercise settlement amounts will be aggregated.²⁵ In determining compliance with the position limits set forth in Rule 22.6, binary options will not be aggregated with non-binary option contracts on the same or similar underlying security or broad-based index.²⁶ In addition, binary options on broad-based indexes will not be aggregated with non-binary option contracts on an underlying stock or stocks included within such broad-based index, and binary options on one broad-based index shall not be aggregated with binary options on any other broad-based index.²⁷

For purposes of the position limits established in Rule 22.6, a long position in a put binary option and a short position in a call binary option will be considered to be on the same side of the market; and a short position in a put binary option and a long position in a call binary option will be considered to be on the same side of the market.²⁸ Binary options will not be subject to the hedge exemption to the standard position limits found in Rule 4.11.²⁹ Under Rule 22.6, the following qualified hedge exemption strategies and positions will be exempt from the established binary option position limits: (1) A binary option position

“hedged” or “covered” by an appropriate amount of cash to meet the settlement obligation (*e.g.*, \$1,000 for a binary option with an exercise settlement amount of \$1,000); (2) a binary option position “hedged” or “covered” by a sufficient amount of a related or similar security to meet the settlement obligation; or (3) a binary option position “hedged” or “covered” by a traditional option covering the same underlying broad-based index sufficient to meet the settlement obligation.³⁰

Binary options will not be subject to exercise limits due to the fact that they are European-style options and are automatically exercised at expiration if the settlement value of the underlying index is equal to or greater than the exercise price of a call binary option or less than the exercise price in the case of a put binary option.³¹

CBOE Rule 22.8, “Reports Related to Position Limits and Liquidation of Positions,” states that references in Rules 4.13, “Reports Related to Position Limits,” and 4.14, “Liquidation of Positions,” to Rule 4.11 in connection with position limits will be deemed, in the case of binary options, to be to Rule 22.6. As such, in accordance with CBOE Rule 4.13(a), a position in a binary option must be reported to the Exchange via the Large Option Positions Report when an account establishes an aggregate same side of the market position of 200 or more binary options. In computing reportable binary options under existing Rule 4.13: (1) Positions in binary options that have different exercise settlement amounts will be aggregated; (2) positions in binary options will not be aggregated with non-binary option contracts on the same or similar underlying security or broad-based index; (3) positions in binary options on broad-based indexes will not be aggregated with non-binary option contracts on an underlying stock or stocks included within such broad-based index; and (4) positions in binary options on one broad-based index will not be aggregated with binary options on any other broad-based index.³² The Exchange believes that the reporting requirements and the surveillance procedures for hedged positions will enable the Exchange to closely monitor sizable positions and corresponding hedges.

E. Margin

The Exchange is amending Rule 12.3, “Margin Requirements,” to include

¹⁴ See *id.*

¹⁵ See CBOE Rule 22.3(c).

¹⁶ See Securities Exchange Act Release No. 56875 (November 30, 2007), 72 FR 69274 (December 7, 2007) (order approving File No. SR-OCC-2007-08).

¹⁷ 17 CFR 240.9b-1.

¹⁸ See CBOE Rule 22.6.

¹⁹ See CBOE Rule 22.6(a).

²⁰ See *id.*

²¹ See CBOE Rule 22.6(b).

²² See CBOE Rule 22.6(b)(4).

²³ See CBOE Rule 22.6(b)(4)(iv).

²⁴ See CBOE Rule 22.6(b)(5).

²⁵ See CBOE Rule 22.6(b)(5)(c).

²⁶ See CBOE Rule 22.6(b)(5)(d).

²⁷ See *id.*

²⁸ See CBOE Rule 22.6(e).

²⁹ See CBOE Rule 22.6(f).

³⁰ See CBOE Rule 22.6(f)(1)–(3).

³¹ See CBOE Rule 22.7.

³² See CBOE Rule 22.8.

requirements applicable to binary options. Under Rule 12.3, as amended, for a Margin Account, no binary option carried for a customer shall be considered of any value for purposes of computing the margin required in the account of such customer.³³ The initial and maintenance margin required on any binary option carried long in a customer's account is 100% of the purchase price of such binary option (*i.e.*, the premium).³⁴ In connection with a short position in a binary option, the customer margin required is the exercise settlement amount.³⁵ As for spreads, no margin is required on a binary call option (put option) carried short in a customer's account that is offset by a long binary call option (put option) for the same underlying security or instrument that expires at the same time and has an exercise price that is less than (greater than) the exercise price of the short call (put).³⁶ The long call (put) must be paid for in full.³⁷ As for a straddle/combination, when a binary call option is carried short in a customer's account and there is also carried a short binary put option that expires at the same time and has an exercise price that is less than or equal to the exercise price of the short call, the initial and maintenance margin required is the exercise settlement amount applicable to one contract.³⁸

For a cash account, a binary option carried short in a customer's account will be deemed a covered position, and eligible for the cash account, if either one of the following is held in the account at the time the option is written or is received into the account promptly thereafter: (1) Cash or cash equivalents equal to 100% of the exercise settlement amount; (2) a long binary option of the same type (put or call) for the same underlying security or instrument that is paid for in full and expires at the same time, and has an exercise price that is less than the exercise price of the short in the case of a call or greater than the exercise price of the short in the case of a put; or (3) an escrow agreement.³⁹ The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement cash, cash equivalents, one or more qualified equity securities, or a combination thereof having an aggregate market value of not less than 100% of the exercise settlement amount and that

the bank will promptly pay the member organization the cash settlement amount in the event the account is assigned an exercise notice.⁴⁰ The Exchange believes that these levels are appropriate because risk exposure is limited with binary options and the customer initial and maintenance margin would be equal to the maximum risk exposure. In addition, under CBOE Rule 12.10, the CBOE may determine at any time to impose higher margin requirements than those described above when it deems such higher margin requirements to be advisable.

F. Bid-Ask Differentials, Minimum Price Variations, and Strike Price Intervals

For each binary index option traded on the Exchange, a market maker is expected to quote so as to create differences between the bid and the offer of no more than the wider of 25% of the designated exercise settlement value or \$5.00, except during the last trading day prior to the expiration, when the maximum permissible price differential is the wider of 50% of the designated exercise settlement value or \$5.00.⁴¹ The minimum price variation for binary index options, established by class, will be no less than \$0.01.⁴² The CBOE will list binary index options using the strike price intervals currently used for traditional index options.⁴³

G. FLEX Trading

Binary options will be eligible for trading as Flexible Exchange Options as provided for in Chapters XXIVA and XXIVB of the CBOE's rules.⁴⁴ The position limit methodology in CBOE Rule 22.6, discussed above, will apply to binary index options traded as Flexible Exchange Options.⁴⁵

H. Other Considerations

The CBOE represents that it believes that the Exchange and the Options Price Reporting Authority have the necessary systems capacity to handle the additional message traffic associated with the listing and trading of binary options on broad-based indexes. In addition, the CBOE represents that it has an adequate surveillance program to monitor trading in binary options on broad-based indexes, and that the Exchange intends to largely apply its existing surveillance program for

options to the trading of binary index options.⁴⁶

III. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁴⁷ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,⁴⁸ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that binary options on broad-based indexes will provide investors with a potentially useful investment choice. The proposal will extend to these options the benefits of a listed exchange market, which include a centralized forum for price discovery, pre- and post-trade transparency, standardized contract specifications, and the guarantee of the OCC.

The Commission believes that the proposal is reasonably designed to address potential manipulation concerns associated with binary options' non-linear return. The initial and continued listing standard established herein provide that the Exchange may list and trade binary options only on broad-based indexes. In addition, these binary options will be a.m.-settled, unless the traditional options on the underlying index are p.m.-settled. These elements should reduce the potential for manipulating the index underlying a binary option to benefit a binary index option position.

The Commission believes that the proposed position limits and margin rules are reasonable and consistent with the Act. The proposed position limits for binary index options appear to reasonably balance the promotion of a free and open market for these securities with minimization of incentives for market manipulation. The proposed margin rules appear reasonably designed to deter a member or its

³³ See CBOE Rule 12.3(m)(1).

³⁴ See CBOE Rule 12.3(m)(1)(i).

³⁵ See CBOE Rule 12.3(m)(1)(ii).

³⁶ See CBOE Rule 12.3(m)(1)(iii).

³⁷ See *id.*

³⁸ See CBOE Rule 12.3(m)(1)(iv).

³⁹ See CBOE Rule 12.3(m)(2).

⁴⁰ See *id.*

⁴¹ See CBOE Rule 22.14(a).

⁴² See CBOE Rule 22.13(b).

⁴³ See CBOE Rule 22.3(d).

⁴⁴ See CBOE Rule 22.16.

⁴⁵ See CBOE Rule 22.16.

⁴⁶ See e-mail message from Jennifer Yeadon, Senior Attorney, CBOE, to Yvonne Fraticelli, Special Counsel, Division of Trading and Markets, dated May 20, 2008.

⁴⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴⁸ 15 U.S.C. 78f(b)(5).

customer from assuming an imprudent position in binary index options.

In support of this proposal, the CBOE made the following representations:

- The CBOE has in place an adequate surveillance program to monitor trading in binary options on broad-based indexes and intends to largely apply its existing surveillance program for options to the trading of binary options on broad-based indexes; and
- The CBOE has the necessary systems capacity to support the new options series that would result from the introduction of binary options on broad-based indexes.

This approval order is based on the CBOE's representations.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁴⁹ that the proposed rule change (SR-CBOE-2006-105), as modified by Amendment No. 2, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵⁰

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. E8-12031 Filed 5-29-08; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57865; File No. SR-CBOE-2008-02]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change, as Modified by Amendment No. 1 Thereto, To Replace References to Certain Committees With a Reference to the Exchange

May 23, 2008.

I. Introduction

On March 17, 2008, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules to replace references to certain committees with a reference to the "Exchange." On April 7, 2008, CBOE submitted Amendment No. 1 to the proposed rule change. The proposed rule change was published for comment

in the **Federal Register** on April 14, 2008.³ The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

The Exchange proposes to amend CBOE Rules to delete certain references to the appropriate Procedure, Floor Officials, appropriate Market Performance, Membership, and Product Development Committees, as well as certain general references to committees such as the "appropriate Exchange committee." These references are being replaced with a reference to the "Exchange."

The Exchange proposes to make these changes to simplify and standardize its delegations of authority with respect to these Exchange committees. Under CBOE's organizational structure, Exchange committees can derive their authority in one of two ways. In addition to any powers and duties specifically granted in CBOE's Constitution or Rules, each committee has such other powers and duties as may be delegated to it by the Board of Directors ("Board").⁴ Thus, in some instances CBOE's Constitution or Rules specifically reference a particular committee or "appropriate Exchange committee." In other instances, the Board separately delegates a particular authority to a committee. Because the authority exercised by committees may be delegated by the Board, the Exchange believes that referencing these committees in the rule text is not necessary. Instead, the Exchange believes a better approach than making a specific reference to the above-listed committees or a general reference to the "appropriate Exchange committee" in the rule text is to simply reference the "Exchange." In this way, the Exchange would have the flexibility to determine who would perform the authorities under the CBOE Rules, which might include Exchange officials or the Board determining to delegate certain authorities to an appropriate Exchange committee.⁵ In addition, deleting references to these committees and

specifying the "Exchange" instead would be more efficient from an administrative perspective because the Exchange would not have to make a rule change merely, for instance, to accommodate a change in the title of a committee or to accommodate the reassignment of an authority to another committee.⁶

In addition, the Exchange proposes various other amendments to CBOE Rules that would accommodate the above-described changes and simplify the pertinent rule text. The Exchange has not proposed any revisions to its current disciplinary, arbitration or appeals procedures (or related Business Conduct, Arbitration and Appeals Committees) as part of the proposed rule change.⁷

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁸ In particular, the Commission finds that the proposal is consistent with Section 6(b)(1) of the Act,⁹ which requires that an exchange be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the Act, the rules and regulations thereunder, and the rules of the exchange. In addition, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹⁰ in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market

⁶ See, e.g., Securities Exchange Act Release Nos. 53537 (March 21, 2006), 71 FR 15778 (March 29, 2006) (SR-CBOE-2006-15) (deleting from the CBOE Rules any specific references to the certain named committees because the Exchange determined to eliminate these committees and reassign their respective authorities to other committees and/or to Exchange staff) and 39479 (December 22, 1997), 62 FR 68326 (December 31, 1997) (SR-CBOE-97-61) (deleting from the CBOE Rules any specific references to, and adding "appropriate" to all references that related to certain named committees).

⁷ The Commission notes that CBOE's committees relating to disciplinary, arbitration, and appeals matters and procedures are specifically defined in the CBOE Rules; any amendments to the rules relating to such committees and procedures would require CBOE to file a proposed rule change under Section 19(b) of the Act. 15 U.S.C. 78s(b).

⁸ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁹ 15 U.S.C. 78f(b)(1).

¹⁰ 15 U.S.C. 78f(b)(5).

³ See Securities Exchange Act Release No. 57629 (April 7, 2008), 73 FR 20076 ("Notice").

⁴ See Rule 2.1(d).

⁵ As indicated above, Exchange committees only have authorities to the extent specifically granted in CBOE's Constitution or Rules or by Board delegation. The Board may also exercise authorities of the "Exchange" under CBOE's Constitution and Rules. In addition, authorities of the "Exchange" may be performed by other Exchange officials. For example, the Exchange's Chief Executive Officer, President or other officials or designees may have authorities of the "Exchange" as long as it is not inconsistent with CBOE's Constitution or Rules or any Board directive.

⁴⁹ 15 U.S.C. 78s(b)(2).

⁵⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.