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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68888; File No. SR-CBOE-2012-120)

February 8, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval to Proposed Rule Change to Establish a Pilot Program, as Modified by Amendment Nos. 2, 3, and 4, to List and Trade a P.M.-Settled S&P 500 Index Option Product

I. Introduction

On December 5, 2012, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) 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 permit the listing and trading of P.M.-settled options on the Standard & Poor’s 500 Index (“S&P 500”). On December 17, 2012, the Exchange filed Amendments No. 1 and 2 to the proposed rule change.³ The proposed rule change was published for comment in the Federal Register on December 26, 2012.⁴ On January 4, 2013, the Exchange filed Amendment No. 3 to the proposed rule change.⁵ On January 29, 2013, the Exchange filed Amendment No. 4 to the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange withdrew Amendment No. 1 on December 17, 2012. In Amendment No. 2, the Exchange represented that it does not believe that CBOE Trading Permit Holders will experience significant operations issues when trading P.M.-settled S&P 500 Index products on CBOE.

⁴ See Securities Exchange Act Release No. 68457 (December 18, 2012), 77 FR 76135 (December 26, 2012) (“Notice”). An amendment to the Notice was published in the Federal Register on January 8, 2013 with a corrected deadline for comments of January 16, 2013. See Securities Exchange Act Release No. 68457 (December 18, 2012), 78 FR 1296 (January 8, 2013).

⁵ In Amendment No. 3, the Exchange explained that any P.M.-settled S&P 500 Index options series that are part of the SPX options class and that have an expiration on any day other than the third Friday of every month will remain under the SPXPM class to avoid investor confusion. Because Amendment No. 3 is technical in nature, the Commission is not publishing it for comment.

proposed rule change.⁶ The Commission received no comment letters on the proposal. This order approves the proposed rule change, as modified, on a twelve-month pilot basis.

II. Description of the Proposal

The Exchange is proposing to amend its rules to permit it to list and trade, on a pilot basis, cash-settled S&P 500 index options with third-Friday-of-the-month (“Expiration Friday”) expiration dates for which the exercise settlement value will be based on the index value derived from the closing prices of component securities (“P.M.-settled”). The proposed contract (referred to as “SPXPM”) is currently traded on a pilot basis on C2 Options Exchange, Incorporated (“C2”) (the “C2 Pilot Program”).⁷ CBOE is proposing to list and trade SPXPM on the same terms as the C2 Pilot Program, except that CBOE intends to list and trade SPXPM for an initial pilot period of twelve months.⁸ CBOE and C2 will not concurrently list and trade SPXPM. In other words, C2 (which is wholly owned by the same corporation, CBOE Holdings, Inc., as CBOE) will cease trading SPXPM upon the introduction of SPXPM trading on CBOE. CBOE initially represented that it intended to begin trading SPXPM on or around January 22, 2013, but in Amendment No. 4, CBOE instead represented its intent to begin trading SPXPM on February 19, 2013.⁹

CBOE will list and trade SPXPM in a manner similar to how SPXPM currently is listed and traded on C2. In particular, SPXPM on CBOE will use a \$100 multiplier, and the minimum

⁶ In Amendment No. 4, the Exchange modified the anticipated start date for the listing and trading of the proposed contract on CBOE from January 22, 2013 to February 19, 2013. See Notice, supra note 4, at 76136. Because Amendment No. 4 is technical in nature, the Commission is not publishing it for comment.

⁷ See Securities Exchange Act Release No. 65256 (September 2, 2011), 76 FR 55969 (September 9, 2011) (“C2 SPXPM Approval Order”).

⁸ The C2 Pilot Program is a fourteen month pilot.

⁹ See Amendment No. 4, supra note 6.

trading increment will be \$0.05 for options trading below \$3.00 and \$0.10 for all other series. Strike price intervals will be set no less than 5 points apart. Consistent with existing rules for index options, the Exchange will allow up to twelve near-term expiration months, as well as LEAPS. Expiration processing will occur on the Saturday following Expiration Friday. The product will have European-style exercise and will not be subject to position limits, though there would be enhanced reporting requirements. The Exchange represents that the conditions for listing SPXPM on CBOE will be similar to those for SPX, which already is listed and traded on CBOE.¹⁰

The Exchange proposes that SPXPM be approved on a pilot basis for an initial period of twelve months. As part of the pilot program, the Exchange committed to submit a pilot program report to the Commission at least two months prior to the expiration date of the pilot program (the “annual report”). The annual report will contain the same information currently provided to the Commission pursuant to the C2 Pilot Program and would include an analysis of volume, open interest, and trading patterns. The analysis will examine trading in the proposed option product as well as trading in the securities that comprise the S&P 500 index. In addition, for series that exceed certain minimum open interest parameters, the annual report will provide analysis of index price volatility and share trading activity. In addition to the annual report, the Exchange committed to provide the Commission with periodic reports while the pilot is in effect that would contain some, but not all, of the information contained in the annual report (“interim reports”). This information is identical to the information that C2 is required to report to the Commission pursuant to the C2 Pilot Program.

¹⁰ See Notice, supra note 4, at 76136.

III. Discussion and Commission Findings

After careful consideration of the proposal, 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,¹¹ and, in particular, the requirements of Section 6 of the Act.¹² Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹³ which requires that an exchange have rules designed to remove impediments to and perfect the mechanism of a free and open market and to protect investors and the public interest, to allow CBOE to conduct a limited, and carefully monitored, pilot as proposed.

As noted in the Commission's order approving the listing and trading of SPXPM on C2 on a pilot program basis, the Commission has concerns about the potential impact on the market at expiration for the underlying component stocks for a P.M.-settled, cash-settled index option such as SPXPM.¹⁴ The potential impact today remains unclear, given the significant changes in the closing procedures of the primary markets over the past two decades. The Commission is mindful of the historical experience with the impact of P.M. settlement of cash-settled index derivatives on the underlying cash markets, but recognizes that these risks may be mitigated today by the enhanced closing procedures that are now in use at the primary equity markets.

To assist the Commission in assessing any potential impact of a P.M.-settled S&P 500 index option on the options markets as well as the underlying cash equities markets, CBOE will be required to submit data to the Commission in connection with the pilot in exactly the same

¹¹ 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).

¹² 15 U.S.C. 78f.

¹³ 15 U.S.C. 78f(b)(5).

¹⁴ See C2 SPXPM Approval Order, supra note 7, at 55972, 55974-55975.

scope and format as C2 was required to submit as a condition of Commission approval of SPXPM on a pilot basis. The Commission believes that CBOE's proposed twelve-month pilot, together with the data and analysis that CBOE will provide to the Commission, will allow CBOE and the Commission to monitor for and assess any potential for adverse market effects. Specifically, the data and analysis will assist the Commission in evaluating the effect of allowing P.M. settlement for S&P 500 index options on the underlying component stocks.

CBOE's proposed twelve-month pilot will enable the Commission to collect current data to assess and monitor for any potential for impact on markets, including the underlying cash equities markets. In particular, the data collected from CBOE's pilot program will help inform the Commission's consideration of whether the SPXPM pilot should be modified, discontinued, extended, or permanently approved. The P.M. settlement pilot information should help the Commission assess the impact on the markets and determine whether other changes are necessary. Furthermore, the Exchange's ongoing analysis of the pilot should help it monitor any potential risks from large P.M.-settled positions and take appropriate action on a timely basis if warranted.

As the Commission noted when it approved C2's proposal to list and trade SPXPM, approval of CBOE's proposal to transfer listing of SPXPM from C2 to CBOE could benefit investors and the public interest to the extent it attracts trading in P.M.-settled S&P 500 index options from the opaque OTC market to the more transparent exchange-listed markets, where trading in the product will be subject to exchange trading rules and exchange surveillance.¹⁵

The Exchange represents that it has adequate surveillance procedures to monitor trading in these options thereby helping to ensure the maintenance of a fair and orderly market, and has

¹⁵ See C2 SPXPM Approval Order, supra note 7, at 55976.

represented that it has sufficient capacity to handle additional traffic associated with this new listing.¹⁶ In addition, CBOE represents that it does not expect that its Trading Permit Holders will experience significant operation issues as a result of the cessation of trading on C2 of SPXPM upon the introduction of trading of SPXPM on CBOE.¹⁷ CBOE stated that there are no C2 Trading Permit Holders that are not also CBOE Trading Permit Holders, so any C2 Trading Permit Holder that is currently trading SPXPM on C2 will have access to trade SPXPM on CBOE.¹⁸

For the reasons discussed above, the Commission finds that CBOE's proposal is consistent with the Act, including Section 6(b)(5) thereof, in that it is designed to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. As it found in the case of C2's original proposal to list and trade SPXPM, and in light of the enhanced closing procedures at the underlying markets and the potential benefits to investors discussed above, the Commission finds that it is appropriate and consistent with the Act to approve CBOE's proposal on a pilot basis. The collection of data during the pilot and CBOE's active monitoring of any effects of SPXPM on the markets will help CBOE and the Commission assess any impact of P.M. settlement in today's market.

¹⁶ See Notice, supra note 4, at 76138.

In addition, the Commission notes that CBOE would have access to information through its membership in the Intermarket Surveillance Group with respect to the trading of the securities underlying the S&P 500 index, as well as tools such as large options positions reports to assist its surveillance of SPXPM options.

In approving the proposed rule change, the Commission also has relied upon the Exchange's representation that it has the necessary systems capacity to support new options series that will result from this proposal. See Notice, supra note 4, at 76138.

¹⁷ See Notice, supra note 4, at 76136.

¹⁸ See Amendment No. 2, supra note 3.

As noted in Amendment No. 4, CBOE represented its intent to begin trading SPXPM on February 19, 2013, which is the first day of a new expiration cycle for options.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-CBOE-2012-120), as modified by Amendment Nos. 2, 3, and 4, be, and hereby is, approved, as amended, on a 12 month pilot basis set to expire on February 8, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Kevin M. O'Neill
Deputy Secretary

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¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).