

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 4002	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - 2011 - * 026	Amendment No. (req. for Amendments *)
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Proposed Rule Change by Chicago Board Options Exchange  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**  
Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked \*).

Proposal to list and trade options on individual stock based volatility indexes and certain exchange-traded fund based volatility indexes.

**Contact Information**  
Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name \* Jenny Last Name \* Klebes  
Title \* Senior Attorney  
E-mail \* klebes@cboe.com  
Telephone \* (312) 786-7466 Fax (312) 786-7919

**Signature**  
Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 03/28/2011  
By Jenny L. Klebes Senior Attorney / Assistant Secretary  
(Name \*) (Title \*)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Jenny Klebes, klebes@cboe.com

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information (required)**

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change (required)**

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

Item 1. Text of the Proposed Rule Change

(a) Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") proposes to amend its rules to list and trade options on individual stock based volatility indexes and certain exchange-traded fund based volatility indexes. CBOE will list a total of 40 combined individual stock and exchange-traded fund based volatility indexes. These are in addition to options on the CBOE Gold ETF Volatility Index ("GVZ"), which has already been approved for trading by the Commission. Such volatility index options must be based on an individual stock option or exchange-traded fund option that already trades on CBOE. The proposed options will be cash-settled and will have European-style exercise. Set forth below are proposed changes to the rule text, with additions represented by underscoring and deletions represented by [bracketing].

(b) Not applicable.

(c) Not applicable.

Chicago Board Options Exchange, Incorporated  
Rules

\* \* \* \* \*

**Rule 12.3—Margin Requirements**

RULE 12.3

(a) – (b) No change.

(c) *Customer Margin Account—Exception.* The foregoing requirements are subject to the following exceptions. Nothing in this paragraph (c) shall prevent a broker-dealer from requiring margin from any account in excess of the amounts specified in these provisions.

(1) – (4) No change.

(5) *Initial and Maintenance Margin Requirements on Short Options, Stock Index Warrants, Currency Index Warrants and Currency Warrants.*

(A) *Listed. General Rule.* The initial and maintenance margin required on any listed put, call, stock index warrant, currency index warrant or currency warrant carried "short" in a customer's account shall be 100% of the current market value of the option or warrant plus the percentage of the current "underlying component value"

(as described in column IV of the table below) specified in column II of the table below reduced by any "out-of-the-money" amount as defined in this subparagraph (c)(5)(A) below.

Notwithstanding the margin required above, the minimum margin for each such call option or call warrant shall not be less than 100% of the current market value of the option or warrant plus the percentage of the current market value of the underlying component specified in column III of the table below, and for each such put option or put warrant, shall not be less than 100% of the current market value of the option or warrant plus the percentage of the option or warrant's aggregate exercise price amount specified in column III of the table below.

<i>I. Type of Option</i>	<i>II. Initial and/or Maintenance Margin Required</i>	<i>III. Minimum Margin Required</i>	<i>IV. Underlying Component Value</i>
1. – 14. No change.			
15. <u>[GVZ]Exchange-traded fund and individual stock based volatility indexes as defined in Rule 24.1(bb)</u>	20%	10%	The product of the index value and the applicable index multiplier

For purposes of this subparagraph (c)(5)(A), "out-of-the-money" amounts are determined as follows:

<i>Option or Warrant Issue</i>	<i>Call</i>	<i>Put</i>
Stock Options, Registered Investment Company Options	Any excess of the aggregate exercise price of the option over the current market value of the equivalent number of shares of the underlying security.	Any excess of the current market value of the equivalent number of shares of the underlying security over the aggregate exercise price of the option.
U.S. Treasury Options	Any excess of the aggregate exercise price of the option over the current market value of the underlying principal amount.	Any excess of the current market value of the underlying principal amount over the aggregate exercise price of the option.
Corporate Debt Security Options	Any excess of the aggregate exercise price of the option over the current market value of the equivalent quantity of the underlying security.	Any excess of the current market value of the equivalent quantity of the underlying security over the aggregate exercise price of the option.
Index stock options,	Any excess of the aggregate	Any excess of the product of

[GVZ]exchange-traded fund and individual stock based volatility index options, currency index warrants and stock index warrants	exercise price of the option or warrant over the product of the current index value and the applicable multiplier.	the current index value and the applicable multiplier over the aggregate exercise price of the option or warrant.
Foreign currency options and warrants	Any excess of the aggregate exercise price of the option or warrant over the product of units per foreign currency contract and the closing spot prices.	Any excess of the product of units per foreign currency contract and the closing spot prices over the aggregate price of the option or warrant.
Interest rate options	Any excess of the aggregate exercise price of the option over the product of the current interest rate measure value and the applicable multiplier.	Any excess of the product of the current interest rate measure value and the applicable multiplier over the aggregate exercise price of the option.

Remainder of Rule 12.3 – No change.

*...Interpretations and Policies:*

**.01 - .19** No change.

\* \* \* \* \*

**Rule 24.1—Definitions**

RULE 24.1

(a) – (aa) No change.

**Exchange-Traded Fund and Individual Stock Based Volatility Index**

**(bb)** The term "Exchange-Traded Fund Based Volatility Index" is an up-to-the-minute market estimate of expected volatility of its corresponding underlying exchange-traded fund calculated by using real-time bid/ask quotes of CBOE listed options overlying that exchange-traded fund. The term "Individual Stock Based Volatility Index" is an up-to-the-minute market estimate of expected volatility of its corresponding underlying stock calculated by using real-time bid/ask quotes of CBOE listed options overlying that stock.

*...Interpretations and Policies:*

**.01** The reporting authorities designated by the Exchange in respect of each index underlying an index option contract traded on the Exchange are as follows:

Index	Reporting Authority
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(Add the following to the current list:)

Exchange-Traded Fund Volatility Indexes.....Chicago Board Options Exchange

Individual Stock Based Volatility Indexes.....Chicago Board Options Exchange

\* \* \* \* \*

**Rule 24.4—Position Limits for Broad-Based Index Options**

RULE 24.4 (a) In determining compliance with Rule 4.11, there shall be no position limits for broad-based index option contracts (including reduced-value option contracts) on CBOE S&P 500 Three-Month Realized Variance, CBOE S&P 500 Three-Month Realized Volatility and on the BXM (1/10th value), DJX, OEX, XEO, NDX, RUT, VIX, VXN, VXD, S&P 500 Dividend Index and SPX classes. All other broad-based index option contracts shall be subject to a contract limitation fixed by the Exchange, which shall not be larger than the limits provided in the chart below.

\* \* \* \* \*

(Delete the following from the current list:)

[CBOE Gold ETF Volatility Index ("GVZ")]	[50,000 contracts]	[no more than 30,000 near-term]
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(b) – (e) No change.

**...Interpretations and Policies:**

**.01 - .03** No change.

**.04** Margin and Clearing Firm Requirements

Whenever the Exchange determines, based on a report by the Department of Market Regulation or otherwise, that additional margin is warranted in light of the risks associated with an under-hedged BXM (1/10<sup>th</sup> value), [GVZ,] SPX, OEX, XEO, NDX, RUT, DJX, VIX, VXN, VXD, S&P 500 Dividend Index, CBOE S&P 500 Three-Month Realized Variance or CBOE S&P 500 Three-Month Realized Volatility option position, the Exchange may consider imposing additional margin upon the account maintaining such under-hedged position pursuant to its authority under Exchange Rule 12.10. Additionally, it should be noted that the clearing firm carrying the account will be subject to capital charges under SEC Rule 15c3-1 to the extent of any margin deficiency resulting from the higher margin requirements.

**.05** No change.

\* \* \* \* \*

**Rule 24.4C—Position Limits for Exchange-Traded Fund and Individual Stock Based Volatility Index Options**

RULE 24.4C.

(a) In determining compliance with Rule 4.11, exchange-traded fund and individual stock based volatility index options shall have a position limit equal to 50,000 contracts on either

side of the market, and no more than 30,000 contracts in the nearest expiration month.

(b) In determining compliance with the position limits set forth in paragraph (a), exchange-traded fund and individual stock based volatility index options shall not be aggregated with the index component option contracts on the corresponding underlying security (e.g., individual stock or exchange-traded fund).

**...Interpretations and Policies:**

**.01 Hedge Exemption**

The hedge exemption for exchange-traded fund and individual stock based volatility index options is in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. The following procedures and criteria must be satisfied to qualify for the hedge exemption:

(a) The account in which the exempt option positions are held ("hedge exemption account") has received prior Exchange approval for the hedge exemption specifying the maximum number of contracts which may be exempt under this Interpretation. The hedge exemption account has provided all information required on Exchange-approved forms and has kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two (2) business days or such other time period designated by the Department of Market Regulation furnish the Department of Market Regulation with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

(b) A hedge exemption account that is not carried by a CBOE TPH organization must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.

(c) The hedge exemption account maintains a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of a net long or short position in exchange-traded fund and individual stock based volatility index futures contracts or in options on exchange traded fund and individual stock based volatility index futures contracts, or long or short positions in exchange-traded fund and individual stock based volatility index options, for which the underlying exchange-traded fund and individual stock based volatility index is included in the same margin or cross-margin product group cleared at the Clearing Corporation as the exchange-traded fund and individual stock based volatility index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.

(d) The exemption applies to positions in exchange-traded fund and individual stock based volatility index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The unhedged value will be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the standard limit, the underlying market value (a) of any economically equivalent opposite side of the market calls and puts in broad-based index

options, and (b) of any opposite side of the market positions in exchange-traded fund and individual stock based volatility index futures, options on exchange-traded fund and individual stock based volatility index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows—the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

(e) Only the following qualified hedging transactions and positions are eligible for purposes of hedging a qualified portfolio (i.e., futures and options) pursuant to this Interpretation .01:

- (1) Long put(s) used to hedge the holdings of a qualified portfolio;
- (2) Long call(s) used to hedge a short position in a qualified portfolio;
- (3) Short call(s) used to hedge the holdings of a qualified portfolio; and
- (4) Short put(s) used to hedge a short position in a qualified portfolio.

The following strategies may be effected only in conjunction with a qualified stock portfolio:

(5) A short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (a "collar"). Neither side of the collar transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 4.11 and 24.4C, a collar position will be treated as one (1) contract;

(6) A long put position coupled with a short put position overlying the same exchange-traded fund and individual stock based volatility index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s) (a "debit put spread position"); and

(7) A short call position accompanied by a debit put spread position, where the short call(s) expires with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Neither side of the short call, long put transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 4.11 and 24.4C, the short call and long put positions will be treated as one (1) contract.

(f) The hedge exemption account shall:

(1) liquidate and establish options, their equivalent or other qualified portfolio products in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes.

(2) liquidate any options prior to or contemporaneously with a decrease in the hedged



value of the qualified portfolio which options would thereby be rendered excessive.

(3) promptly notify the Exchange of any material change in the qualified portfolio which materially affects the unhedged value of the qualified portfolio.

(g) If an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted.

\* \* \* \* \*

#### **Rule 24.5—Exercise Limits**

RULE 24.5. In determining compliance with Rule 4.12, exercise limits for index option contracts shall be equivalent to the position limits prescribed for option contracts with the nearest expiration date in Rule 24.4 [or] 24.4A or 24.4C. There shall be no exercise limits for broad-based index options (including reduced-value option contracts) on CBOE S&P 500 Three-Month Realized Variance, CBOE S&P 500 Three-Month Realized Volatility and on the BXM (1/10th value), DJX, OEX, XEO, NDX, RUT, VIX, VXN, VXD, S&P 500 Dividend Index, or SPX.

*...Interpretations and Policies:*

**.01 - .03** No change.

**.04** With respect to exchange-traded fund and individual stock based volatility index options contracts for which an exemption has been granted in accordance with the provisions of Interpretation and Policy .01 to Rule 24.4C, the exercise limit shall be equal to the amount of the exemption.

\* \* \* \* \*

#### **Rule 24.6—Days and Hours of Business**

RULE 24.6. The Board of Directors has resolved that, except as otherwise provided in this Rule or under unusual conditions as may be determined by the Board or its designee, transactions in index options may be effected on the Exchange between the hours of 8:30 a.m. Chicago time and 3:15 p.m. Chicago time. With respect to options on foreign indexes, the Board's designee shall determine the days and hours of business. Transactions in the following index options may be effected on the Exchange between the hours of 8:30 a.m. Chicago time and 3:00 p.m. Chicago time:

(i) – (xli) No change.

(xlii) Exchange-traded fund volatility indexes

*...Interpretations and Policies:*

**.01** No change.

**.02** Transactions in exchange-traded fund volatility indexes may be effected on the Exchange between the hours of 8:30 a.m. Chicago time and 3:15 p.m. (Chicago time), except that if the

closing time for traditional options on the exchange-traded fund is earlier than 3:15 p.m. (Chicago time), the earlier closing time shall apply.

\* \* \* \* \*

### **Rule 24.9—Terms of Index Option Contracts**

RULE 24.9. (a) General.

(1) - (2) No change.

(3) "*European-Style Exercise*". The following European-style index options, some of which are A.M.-settled as provided in paragraph (a)(4), are approved for trading on the Exchange:

(i)- (xxii)	No change.
[(xxiii – xxvi)	[Reserved.]]
<u>(xxiii)</u>	<u>Exchange-traded fund volatility indexes</u>
<u>(xxiv)</u>	<u>Individual stock volatility indexes</u>
<u>(xxv) – (xxvi)</u>	[Reserved.]
(xxvii) – (xcvii)	No change.

(4) *A.M.-Settled Index Options*. The last day of trading for non-Volatility A.M.-settled index options shall be the business day preceding the last day of trading in the underlying securities prior to expiration. The last day of trading for Volatility Index, [and GVZ] exchange-traded fund volatility index options and individual stock volatility index options is governed by subparagraph (5) below. The current index value at the expiration of an A.M.-settled index option shall be determined, for all purposes under these Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration, by reference to the reported level of such index as derived from the opening prices of the underlying securities on such day, as determined by the market for such security selected by the Reporting Authority pursuant to Interpretation and Policy .09 to Rule 24.9, except that in the event that the primary market for an underlying security does not open for trading, halts trading prematurely, or otherwise experiences a disruption of normal trading on that day, or in the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading, halts trading prematurely, or otherwise experiences a disruption of normal trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 24.7(e). The current index level at the expiration of an A.M.- settled S&P 500 Dividend Index option shall be a special quotation of the S&P 500 Dividend Index as determined by the Reporting Authority pursuant to Interpretation and Policy .09 to Rule 24.9, except that in the event that the Reporting Authority is unable to calculate a special quotation of the S&P 500 Dividend Index, the special quotation shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 24.7(e).

The following A.M.-settled index options are approved for trading on the Exchange:

(i) – (xxi)	No change.
[(xxii) – xxiv)	[Reserved.]]
<u>(xxii)</u>	<u>Exchange-traded fund volatility indexes</u>

(xxiii)	<u>Individual stock volatility indexes</u>
(xxiv)	[Reserved.]
(xxv)–(lxxxvi)	No change.

(5) *Method of Determining Day that Exercise Settlement Value will be Calculated and of Determining Expiration Date and Last Trading Day for Volatility Index (e.g., VIX, RVX, VXD, VXN, exchange-traded fund volatility index, and individual stock volatility index) options ("Volatility Index options") [and CBOE Gold ETF Volatility Index ("GVZ") options].* The exercise settlement value of a Volatility Index [or a GVZ] option for all purposes under these Rules and the Rules of the Clearing Corporation, shall be calculated on the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which the Volatility Index [or a GVZ] option expires. If the third Friday of the month subsequent to the expiration of the Volatility Index [or a GVZ] option is an Exchange holiday, the exercise settlement value shall be calculated on the business day that is thirty days prior to the Exchange business day immediately preceding that Friday. The exercise settlement value of a Volatility Index [or a GVZ] option for such purposes shall be calculated by the Exchange as a Special Opening Quotation (SOQ) of the applicable Volatility Index [or a GVZ] using the sequence of opening prices of the options that comprise the Volatility Index [or a GVZ]. The opening price for any series in which there is no trade shall be the average of that option's bid price and ask price as determined at the opening of trading. The expiration date of a Volatility Index [or a GVZ] option shall be the same day that the exercise settlement value of the Volatility Index [or a GVZ] option is calculated. The last trading day for a Volatility Index [or a GVZ] option shall be the business day immediately preceding the expiration date of the Volatility Index [or a GVZ] option.

(b) – (e) No change.

**...Interpretations and Policies:**

**.01** The procedures for adding and deleting strike prices for index options are provided in Rule 5.5 and Interpretations and Policies related thereto, as otherwise generally provided by Rule 24.9, and include the following:

(a) The interval between strike prices will be no less than \$5.00; provided, that in the case of the following classes of index options, the interval between strike prices will be no less than \$2.50:

(i) – (lxiii)	No change.
(lxiv)	<u>Exchange-traded fund volatility indexes</u>
(lxv)	<u>Individual stock volatility indexes</u>

(b)- (d) No change.

(e) [(i) Notwithstanding paragraph (a), the interval between strike prices for options on the CBOE Russell 2000 Volatility Index (RVX), CBOE Dow Jones Industrial Average Volatility Index (VXD) and the CBOE Nasdaq-100 Volatility Index (VXN) will be no less than \$2.50; provided, that subject to the following conditions, the interval between strike prices for RVX, VXD and VXN will be no less than \$1.00:

(A) The Exchange may open for trading series at \$1.00 or greater strike price intervals for each expiration on up to 5 RVX, VXD and VXX option and LEAPs series above and 5 RVX, VXD and VXX option and LEAPs series below the current index level;

(B) As the current index level of RVX, VXD and VXX moves from the exercise price of those RVX, VXD and VXX options and LEAPs series that already have been opened for trading on the Exchange, the Exchange may open for trading additional series at \$1.00 or greater strike price intervals for each expiration on up to 5 RVX, VXD and VXX option and LEAPs series above and 5 RVX, VXD and VXX option and LEAPs series below the current index level;

(C) The Exchange may not open for trading series with \$1.00 intervals within \$0.50 of an existing \$2.50 strike price with the same expiration month; and

(D) Reserved.

(ii) For the purposes of adding strike prices on options and LEAPs on RVX, VXD and VXX at \$1.00 or greater strike price intervals, as well as at \$2.50 or greater strike price intervals, the "current index level" shall mean the implied forward level based on RVX, VXD and VXX futures prices.] Reserved.

(f) – (h) No change.

(i) [In addition to the strike price intervals permitted under Interpretation and Policy .01(a) to Rule 24.9, the Exchange may also list series at 1 point strike price intervals for GVZ options, subject to following conditions:

(i) Initial Series. The Exchange will list in-, at- and out-of-the-money strike prices, and may open for trading up to five series above and five series below the calculated forward value of GVZ, and LEAPs series.

(ii) Additional Series. In response to customer demand or as the calculated forward value of GVZ moves from the initial exercise prices of option series that have been opened for trading, the Exchange may open for trading up to five series above and five series below the calculated forward value of GVZ, and LEAPs series.

(iii) The Exchange may not open for trading series with 1 point strike price intervals within 0.50 point of an existing 2.5 point strike price with the same expiration month.

(iv) The Exchange shall not list LEAPs on GVZ options at strike price intervals less than 1 point.] Reserved.

(j) – (k) No change.

(l) Notwithstanding paragraph (a), the interval between strike prices for [options on the CBOE] Volatility Index options [(VIX)] (as defined in Rule 24.9(a)(5)) will be \$1 or greater where the strike price is \$200 or less and \$5 or greater where the strike price is greater than \$200.

**.02 - .11** No change.

\* \* \* \* \*

**Rule 24A.7 — Position Limits and Reporting Requirements**

RULE 24A.7.

(a) FLEX Index Options

(1) In determining compliance with Rules 4.11, 24.4, 24.4A, [and] 24.4B, and 24.4C FLEX Index Options shall be subject to FLEX contract position limitations fixed by the Exchange in accordance with the provisions of this Rule.

(2) – (4) No change.

(5) The position limits for FLEX [GVZ] exchange-traded fund and individual stock volatility Index Options are equal to the position limits for Non-FLEX [GVZ] Options for the same underlying exchange-traded fund or individual stock volatility index. [established pursuant to Rule 24.4].

(b) – (c) No change.

(d) Aggregation of Positions. For purposes of the position limits and reporting requirements set forth in this Rule, FLEX Option positions shall not be aggregated with positions in Non-FLEX Options other than as provided below, and positions in FLEX Index Options on a given index shall not be aggregated with options on any stocks included in the index or with FLEX Index Option positions on another index.

(1) – (3) No change.

(4) As long as the options positions remain open, positions in FLEX [GVZ] exchange-traded fund and individual stock volatility index Options that expire on the same day as Non-FLEX [GVZ] Options on the same exchange-traded fund or individual stock volatility index, as determined pursuant to Rule 24.9(a)(5), shall be aggregated with positions in Non-FLEX [GVZ] exchange-traded fund and individual stock volatility index Options and shall be subject to the position limits set forth in Rules 4.11, 24.4, 24.4A, [and] 24.4B[,] and 24.4C and the exercise limits set forth in Rules 4.12 and 24.5.

This rule supplements Rule 4.11 generally, but supersedes Interpretations .02 and .04 of Rule 4.11 and all of Rules 24.4, Rule 24.4A, Rule 24.4B, 24.4C and Rule 29.5 except to the extent those Rules are referred to in this rule.

**Rule 24A.8 — Exercise Limits**

RULE 24A.8.

(a) In determining compliance with Rules 4.12 and 24.5, exercise limits for FLEX Index and FLEX [GVZ] exchange-traded fund and individual stock volatility index Options shall be

equivalent to the FLEX position limits prescribed in Rule 24A.7. There shall be no exercise limits for broad-based FLEX Index Options (including reduced-value option contracts) on BXM (1/10th value), DJX, NDX, OEX, RUT, S&P 500 Dividend Index, SPX, VIX, VXN, VXD, CBOE S&P 500 Three-Month Realized Variance, CBOE S&P 500 Three-Month Realized Volatility and XEO.

(b) – (d) No change.

\* \* \* \* \*

### **Rule 24B.7 — Position Limits and Reporting Requirements**

RULE 24B.7.

(a) FLEX Index Options

(1) – (4) No change.

(5) The position limits for FLEX [GVZ] exchange-traded fund and individual stock volatility index Options are equal to the position limits for Non-FLEX [GVZ] exchange-traded fund and individual stock volatility index Options established pursuant to Rule 24.4C.

(b) – (c) No change.

(d) Aggregation of Positions

For purposes of the position limits and reporting requirements set forth in this Rule, FLEX Option positions shall not be aggregated with positions in Non-FLEX Options other than as provided below, and positions in FLEX Index Options on a given index shall not be aggregated with options on any stocks included in the index or with FLEX Index Option positions on another index.

(1) – (3) No change.

(4) As long as the options positions remain open, positions in FLEX [GVZ] exchange-traded fund and individual stock volatility index Options that expire on the same day as Non-FLEX [GVZ] exchange-traded fund and individual stock volatility index Options, as determined pursuant to Rule 24.9(a)(5), shall be aggregated with positions in Non-FLEX [GVZ] Options on the same exchange-traded fund and individual stock volatility index and shall be subject to the position limits set forth in Rules 4.11, 24.4, 24.4A, [and] 24.4B[,] and 24.4C and the exercise limits set forth in Rules 4.12 and 24.5.

This rule supplements Rule 4.11 generally, but supersedes Interpretations .02 and .04 of Rule 4.11 and all of Rules 24.4, 24.4A, 24.4B, 24.4C and 29.5 except to the extent those Rules are referred to in this rule.

**Rule 24B.8. — Exercise Limits**

## RULE 24B.8.

(a) In determining compliance with Rules 4.12 and 24.5, exercise limits for FLEX Index and FLEX [GVZ,] exchange-traded fund and individual stock volatility index Options shall be equivalent to the FLEX position limits prescribed in Rule 24B.7. There shall be no exercise limits for broad-based FLEX Index Options (including reduced-value option contracts) on BXM (1/10th value), DJX, NDX, OEX, RUT, S&P 500 Dividend Index, SPX, VIX, VXN, VXD, CBOE S&P 500 Three-Month Realized Variance, CBOE S&P 500 Three-Month Realized Volatility and XEO.

(b) – (d) No change.

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Item 2. Procedures of the Self-Regulatory Organization

(a) CBOE's Office of the Chairman pursuant to delegated authority approved the proposed rule change on March 11, 2011. No further action is required.

(b) Please refer questions and comments on the proposed rule change to Joanne Moffic-Silver, General Counsel, CBOE, 400 South LaSalle, Chicago, IL 60605, (312) 786-7462 or to Jenny L. Klebes, (312) 786-7466.

Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change(a) Purpose

The purpose of this proposed rule change is to permit the Exchange to list and trade cash-settled, European-style options on individual stock-based volatility indexes and select exchange-traded fund based volatility indexes (collectively, "Vol Indexes"). CBOE proposes to list a total of 40 combined Vol Indexes. Initially, CBOE proposes to list options on Vol Indexes comprised of options on the following individual stocks: Apple Computer, Amazon, IBM, Google, and Goldman Sachs. In addition, CBOE will list Vol Indexes comprised of options on the following exchange-traded funds ("ETFs"): the US Oil Fund, LP ("USO"), the iShares MSCI Emerging Markets Index Fund ("EEM"), the iShares FTSE China 25 Index Fund ("FXI"), the iShares MSCI Brazil Index Fund ("EWZ"), the Market Vectors Gold

Miners ETF ("GDX"), and the Energy Select Sector SPDR ETF ("XLE"). These are in addition to options on the CBOE Gold ETF Volatility Index ("GVZ"), which has already been approved for trading by the Commission.<sup>1</sup> From time to time, CBOE will announce the remaining Vol Indexes options it will trade.

In addition to GVZ, CBOE currently has approval to trade options on other volatility indexes that measure the volatility of broad-based indexes.<sup>2</sup> The Exchange now wants to add volatility index options based on individual stock options that are very actively traded and on certain ETF options. This proposal would permit the Exchange to trade a Vol Index using any ETF option currently trading and eligible for options trading under Interpretations and Policies .06 and .07 to Rule 5.3 other than those ETFs specifically identified in Interpretation and Policy .06(iv). CBOE will continue to trade GVZ options under the prior approval issued by the Commission. The calculation of any Vol Index will use the same methodology, as described below, as is currently used for CBOE Volatility Index ("VIX") and GVZ options.

#### Index Design and Calculation

The calculation of a Vol Index will be based on the VIX and GVZ methodology applied to options on the individual stock or exchange-traded fund that is the subject of the particular Vol Index. A Vol Index is an up-to-the-minute market estimate of the expected volatility of the underlying individual stock or exchange-traded fund calculated by using real-time bid/ask quotes of CBOE listed options on the underlying instruments. A Vol Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected (implied) volatility.<sup>3</sup>

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<sup>1</sup> See Securities Exchange Act Release No. 62139 (May 19, 2010) 75 FR 29597 (May 26, 2010) (order approving proposal to list and trade GVZ options on the CBOE).

<sup>2</sup> See Rule 24.9(a)(4) which identifies, *inter alia*, CBOE Volatility Index, CBOE Nasdaq 100 Volatility Index, CBOE Dow Jones Industrial Average Volatility Index and CBOE Russell 2000 Volatility Index as A.M.-settled index options eligible for options trading on CBOE.

<sup>3</sup> See proposed new definitions of "Exchange-Traded Fund and Individual Stock Based Volatility Index" set forth in Rule 24.1(bb).



For each contract month, CBOE will determine the at-the-money strike price. The Exchange will then select the at-the-money and out-of-the money series with non-zero bid prices and determine the midpoint of the bid-ask quote for each of these series. The midpoint quote of each series is then weighted so that the further away that series is from the at-the-money strike, the less weight that is accorded to the quote. Then, to compute the index level, CBOE will calculate a volatility measure for the nearby options and then for the second nearby options. This is done using the weighted mid-point of the prevailing bid-ask quotes for all included option series with the same expiration date. These volatility measures are then interpolated to arrive at a single, constant 30-day measure of volatility.<sup>4</sup>

CBOE will compute values for Vol Index underlying option series on a real-time basis throughout each trading day, from 8:30 a.m. until 3:00 p.m. (Chicago time) (or until 3:15 p.m. (Chicago time) as applicable for certain Exchange-Traded Fund Based Volatility Index options). Vol Index levels will be calculated by CBOE and disseminated at 15-second intervals to major market data vendors.

### Options Trading

Vol Index options will be quoted in index points and fractions and one point will equal \$100. The minimum tick size for series trading below \$3 will be 0.05 (\$5.00) and above \$3 will be 0.10 (\$10.00). Initially, the Exchange will list in-, at- and out-of-the-money strike prices and the procedures for adding additional series are provided in Rule 5.5.<sup>5</sup> Dollar strikes (or greater) will be permitted for Vol Index options where the strike price is \$200 or less and \$5 or greater where the strike price is greater than \$200.

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<sup>4</sup> CBOE will be the reporting authority for any Vol Index.

<sup>5</sup> See Rule 5.5(c). "Additional series of options of the same class may be opened for trading on the Exchange when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying...moves substantially from the initial exercise price or prices." For purposes of this rule, "market price" shall mean the implied forward level based on any corresponding futures price or the calculated forward value of the respective Vol index.

Transactions in Vol Index options may be effected on the Exchange between the hours of 8:30 a.m. Chicago time and 3:15 p.m. (Chicago time), except (for Exchange-Traded Fund Based Volatility Index options) if the closing time for traditional options on the exchange-traded fund is earlier than 3:15 p.m. (Chicago time), the earlier closing time shall apply. The Exchange is proposing to permit different closing times for Exchange-Traded Fund Based Volatility Index options because the trading hours for traditional options on ETFs vary.

#### Exercise and Settlement

The proposed options will typically expire on the Wednesday that is 30 days prior to the third Friday of the calendar month immediately following the expiration month (the expiration date of the options used in the calculation of the index). If the third Friday of the calendar month immediately following the expiring month is a CBOE holiday, the expiration date will be 30 days prior to the CBOE business day immediately preceding that Friday. For example, November 2011 Vol Index options would expire on Wednesday, November 16, 2011, exactly 30 days prior to the third Friday of the calendar month immediately following the expiring month.

Trading in the expiring contract month will normally cease at 3:00 pm (Chicago time) (or at 3:15 p.m. (Chicago time) as applicable for Exchange-Traded Fund Based Volatility Index options) on the business day immediately preceding the expiration date.<sup>6</sup> Exercise will result in delivery of cash on the business day following expiration. Vol Index options will be A.M.-settled.<sup>7</sup> The exercise settlement value will be determined by a Special Opening Quotations ("SOQ") of a Vol Index calculated from the sequence of opening prices of a

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<sup>6</sup> See proposed amendment to Rule 24.6, Days and Hours of Business.

<sup>7</sup> See proposed amendment to Rule 24.9(a)(4) (adding Exchange-traded fund volatility indexes and Individual stock volatility indexes to the list of A.M.-settled index options approved for trading on the Exchange).

single strip of options expiring 30 days after the settlement date. The opening price for any series in which there are is no trade shall be the average of that options' bid price and ask price as determined at the opening of trading.<sup>8</sup>

The exercise-settlement amount will be equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by \$100. When the last trading day is moved because of a CBOE holiday, the last trading day for expiring options will be the day immediately preceding the last regularly-scheduled trading day.

#### Position and Exercise Limits

For regular options trading, the Exchange is proposing to establish position limits for Vol Index options at 50,000 contracts on either side of the market and no more than 30,000 contracts in the nearest expiration month. CBOE believes that a 50,000 contract position limit is appropriate due to the fact that the options which are the underlying components for a Vol Index are among the most actively traded option classes currently listed. In determining compliance with these proposed position limits, Vol Index options will not be aggregated with the underlying exchange-traded fund or individual stock options. Exercise limits will be the equivalent to the proposed position limits.<sup>9</sup> Vol Index options will be subject to the same reporting requirements triggered for other options dealt in on the Exchange.

For FLEX options trading, the Exchange is proposing that the position limits for FLEX Vol Index Options will be equal to the position limits for Non-FLEX Options on the same Vol Index. Similarly, the Exchange is proposing that the exercise limits for FLEX Vol Index Options will be equivalent to the position limits established pursuant to Rule 24.4. The

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<sup>8</sup> See proposed amendment to Rule 24.9(a) (5) (revising rule to make "Volatility Index" options generic for purposes of this provision, which sets forth the method of determining the day that the exercise settlement value is calculated and of determining the expiration date and the last trading day for CBOE Volatility Index Options). The Exchange is also proposing to make technical changes to this rule provision as well.

<sup>9</sup> See proposed amendment to rule 24.5 and proposed new Interpretations and Policy .04 to rule 24.5.

proposed position and exercise limits for FLEX Vol Index Options are consistent with the treatment of position and exercise limits for Flex GVZ and other Flex Index Options. The Exchange is also proposing to amend subparagraph (4) to Rules 24A.7(d) and 24B.7(d) to provide that as long as the options positions remain open, positions in FLEX Vol Index Options that expire on the same day as Non-FLEX Vol Index Options, as determined pursuant to Rule 24.9(a)(5), shall be aggregated with positions in Non-FLEX Vol Index Options and shall be subject to the position limits set forth in Rules 4.11, 24.4, 24.4A and 24.4B, and the exercise limits set forth in Rules 4.12 and 24.5.

The Exchange is proposing to establish a Vol Index Hedge Exemption, which would be in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. The Exchange proposes to establish the following procedures and criteria which must be satisfied to qualify for a Vol Index hedge exemption:

- The account in which the exempt option positions are held ("hedge exemption account") has received prior Exchange approval for the hedge exemption specifying the maximum number of contracts which may be exempt under the proposed new Interpretation. The hedge exemption account has provided all information required on Exchange-approved forms and has kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two (2) business days or such other time period designated by the Department of Market Regulation furnish the Department of Market Regulation with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.
- A hedge exemption account that is not carried by a CBOE member organization must be carried by a member of a self-regulatory organization participating in the

Intermarket Surveillance Group.

- The hedge exemption account maintains a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of a net long or short position in Equity-Based Volatility Index futures contracts or in options on Vol Index futures contracts, or long or short positions in Vol Index options, for which the underlying Vol Index is included in the same margin or cross-margin product group cleared at the Clearing Corporation as the Vol Index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.
- The exemption applies to positions in Vol Index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The unhedged value will be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the standard limit, the underlying market value (a) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (b) of any opposite side of the market positions in Vol Index futures, options on Vol Index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows—the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.
- Only the following qualified hedging transactions and positions will be eligible for purposes of hedging a qualified portfolio (i.e. futures and options) pursuant to the

propose new Interpretation .01:

- Long put(s) used to hedge the holdings of a qualified portfolio;
  - Long call(s) used to hedge a short position in a qualified portfolio;
  - Short call(s) used to hedge the holdings of a qualified portfolio; and
  - Short put(s) used to hedge a short position in a qualified portfolio.
- The following strategies may be effected only in conjunction with a qualified stock portfolio:
    - A short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s)(a "collar"). Neither side of the collar transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 4.11 and proposed Rule 24.4C, a collar position will be treated as one (1) contract;
    - A long put position coupled with a short put position overlying the same Vol Index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s) (a "debit put spread position"); and
    - A short call position accompanied by a debit put spread position, where the short call(s) expires with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Neither side of the short call, long put transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 4.11 and proposed Rule 24.4C, the short call and long put positions will be treated as one (1) contract.
  - The hedge exemption account shall:

- liquidate and establish options, their equivalent or other qualified portfolio products in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes.
- liquidate any options prior to or contemporaneously with a decrease in the hedged value of the qualified portfolio which options would thereby be rendered excessive.
- promptly notify the Exchange of any material change in the qualified portfolio which materially affects the unhedged value of the qualified portfolio.
- If an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted.

Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX, XXIV, XXIVA, and XXIVB will equally apply to Vol Index options.

The Exchange is proposing that the margin requirements for Vol Index options be set at the same levels that apply to equity options under Exchange Rule 12.3. Margin of up to 100% of the current market value of the option, plus 20% of the underlying volatility index value must be deposited and maintained. The pertinent provisions of Rule 12.3, Margin Requirements, have been amended to reflect these proposed revisions. Additional margin may be required pursuant to Exchange Rule 12.10.

The Exchange hereby designates Vol Index options as eligible for trading as Flexible Exchange Options as provided for in Chapters XXIVA (Flexible Exchange Options) and XXIVB (FLEX Hybrid Trading System). The Exchange notes that Vol Index FLEX Options will only expire on business days that non-FLEX options on Vol Indexes expire. This is because the term "exercise settlement value" in Rules 24A.4(b)(3) and 24B.4(b)(3), *Special*

*Terms for FLEX Index Options*, has the same meaning set forth in Rule 24.9(5). As is described earlier, the Exchange is proposing to amend Rule 24.9(a)(5) to provide that the exercise settlement value of Vol Index options for all purposes under CBOE Rules will be calculated as the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which a Vol Index options expire.

#### Capacity

CBOE has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority have the necessary systems capacity to handle the additional traffic associated with the listing of new series that would result from the introduction of Vol Index options.

#### Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the Exchange's other index options to monitor trading in Vol Index options. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in options on these volatility indexes. For surveillance purposes, the Exchange will have complete access to information regarding trading activity in the pertinent underlying securities.

#### (b) Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b)<sup>10</sup> of the Securities Exchange Act of 1934 (the "Act"), in general, and furthers the objectives of Section 6(b)(5)<sup>11</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove

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<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).



impediments to and perfect the mechanisms of a free and open market in a manner consistent with the protection of investors and the public interest. The Exchange believes that the introduction of Vol Index options will attract order flow to the Exchange, increase the variety of listed options to investors, and provide a valuable hedging tool to investors.

Item 4. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

Item 6. Extension of Time Period for Commission Action

Not applicable.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

Item 8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

Item 9. Exhibits

Exhibit 1. Notice of the proposed rule change for publication in the Federal Register.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-CBOE-2011-026)

Dated: \_\_\_\_\_

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule to Trade Options on Individual Stock Based Volatility Indexes and Certain Exchange-Traded Fund Based Volatility Indexes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on \_\_\_\_\_, 2011, 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, II, and III 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

CBOE proposes to amend its rules to list and trade options on individual stock based volatility indexes and certain exchange-traded fund based volatility indexes. CBOE will list a total of 40 combined individual stock and exchange-traded fund based volatility indexes. These are in addition to options on the CBOE Gold ETF Volatility Index ("GVZ"), which has already been approved for trading by the Commission. Such volatility index options must be based on an individual stock option or exchange-traded fund option that already trades on CBOE. The proposed options will be cash-settled and will have European-style exercise. The text of the rule proposal is available on the Exchange's website

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

(<http://www.cboe.org/legal>), at the Exchange's Office of the Secretary and at the Commission.

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 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of this proposed rule change is to permit the Exchange to list and trade cash-settled, European-style options on individual stock-based volatility indexes and select exchange-traded fund based volatility indexes (collectively, "Vol Indexes"). CBOE proposes to list a total of 40 combined Vol Indexes. Initially, CBOE proposes to list options on Vol Indexes comprised of options on the following individual stocks: Apple Computer, Amazon, IBM, Google, and Goldman Sachs. In addition, CBOE will list Vol Indexes comprised of options on the following exchange-traded funds ("ETFs"): the US Oil Fund, LP ("USO"), the iShares MSCI Emerging Markets Index Fund ("EEM"), the iShares FTSE China 25 Index Fund ("FXI"), the iShares MSCI Brazil Index Fund ("EWZ"), the Market Vectors Gold Miners ETF ("GDX"), and the Energy Select Sector SPDR ETF ("XLE"). These are in addition to options on the CBOE Gold ETF Volatility Index ("GVZ"), which has already

been approved for trading by the Commission.<sup>3</sup> From time to time, CBOE will announce the remaining Vol Indexes options it will trade.

In addition to GVZ, CBOE currently has approval to trade options on other volatility indexes that measure the volatility of broad-based indexes.<sup>4</sup> The Exchange now wants to add volatility index options based on individual stock options that are very actively traded and on certain ETF options. This proposal would permit the Exchange to trade a Vol Index using any ETF option currently trading and eligible for options trading under Interpretations and Policies .06 and .07 to Rule 5.3 other than those ETFs specifically identified in Interpretation and Policy .06(iv). CBOE will continue to trade GVZ options under the prior approval issued by the Commission. The calculation of any Vol Index will use the same methodology, as described below, as is currently used for CBOE Volatility Index ("VIX") and GVZ options.

#### Index Design and Calculation

The calculation of a Vol Index will be based on the VIX and GVZ methodology applied to options on the individual stock or exchange-traded fund that is the subject of the particular Vol Index. A Vol Index is an up-to-the-minute market estimate of the expected volatility of the underlying individual stock or exchange-traded fund calculated by using real-time bid/ask quotes of CBOE listed options on the underlying instruments. A Vol Index uses nearby and second nearby options with at least 8 days left to expiration and then weights them to yield a constant, 30-day measure of the expected (implied) volatility.<sup>5</sup>

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<sup>3</sup> See Securities Exchange Act Release No. 62139 (May 19, 2010) 75 FR 29597 (May 26, 2010) (order approving proposal to list and trade GVZ options on the CBOE).

<sup>4</sup> See Rule 24.9(a)(4) which identifies, *inter alia*, CBOE Volatility Index, CBOE Nasdaq 100 Volatility Index, CBOE Dow Jones Industrial Average Volatility Index and CBOE Russell 2000 Volatility Index as A.M.-settled index options eligible for options trading on CBOE.

For each contract month, CBOE will determine the at-the-money strike price. The Exchange will then select the at-the-money and out-of-the money series with non-zero bid prices and determine the midpoint of the bid-ask quote for each of these series. The midpoint quote of each series is then weighted so that the further away that series is from the at-the-money strike, the less weight that is accorded to the quote. Then, to compute the index level, CBOE will calculate a volatility measure for the nearby options and then for the second nearby options. This is done using the weighted mid-point of the prevailing bid-ask quotes for all included option series with the same expiration date. These volatility measures are then interpolated to arrive at a single, constant 30-day measure of volatility.<sup>6</sup>

CBOE will compute values for Vol Index underlying option series on a real-time basis throughout each trading day, from 8:30 a.m. until 3:00 p.m. (Chicago time) (or until 3:15 p.m. (Chicago time) as applicable for certain Exchange-Traded Fund Based Volatility Index options). Vol Index levels will be calculated by CBOE and disseminated at 15-second intervals to major market data vendors.

### Options Trading

Vol Index options will be quoted in index points and fractions and one point will equal \$100. The minimum tick size for series trading below \$3 will be 0.05 (\$5.00) and above \$3 will be 0.10 (\$10.00). Initially, the Exchange will list in-, at- and out-of-the-money strike prices and the procedures for adding additional series are provided in Rule 5.5.<sup>7</sup>

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<sup>5</sup> See proposed new definitions of "Exchange-Traded Fund and Individual Stock Based Volatility Index" set forth in Rule 24.1(bb).

<sup>6</sup> CBOE will be the reporting authority for any Vol Index.

<sup>7</sup> See Rule 5.5(c). "Additional series of options of the same class may be opened for trading on the Exchange when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying...moves substantially from the initial exercise price or prices." For purposes of this rule, "market price" shall mean the implied forward level based on any corresponding futures

Dollar strikes (or greater) will be permitted for Vol Index options where the strike price is \$200 or less and \$5 or greater where the strike price is greater than \$200.

Transactions in Vol Index options may be effected on the Exchange between the hours of 8:30 a.m. Chicago time and 3:15 p.m. (Chicago time), except (for Exchange-Traded Fund Based Volatility Index options) if the closing time for traditional options on the exchange-traded fund is earlier than 3:15 p.m. (Chicago time), the earlier closing time shall apply. The Exchange is proposing to permit different closing times for Exchange-Traded Fund Based Volatility Index options because the trading hours for traditional options on ETFs vary.

#### Exercise and Settlement

The proposed options will typically expire on the Wednesday that is 30 days prior to the third Friday of the calendar month immediately following the expiration month (the expiration date of the options used in the calculation of the index). If the third Friday of the calendar month immediately following the expiring month is a CBOE holiday, the expiration date will be 30 days prior to the CBOE business day immediately preceding that Friday. For example, November 2011 Vol Index options would expire on Wednesday, November 16, 2011, exactly 30 days prior to the third Friday of the calendar month immediately following the expiring month.

Trading in the expiring contract month will normally cease at 3:00 pm (Chicago time) (or at 3:15 p.m. (Chicago time) as applicable for Exchange-Traded Fund Based Volatility Index options) on the business day immediately preceding the expiration date.<sup>8</sup> Exercise will

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price or the calculated forward value of the respective Vol index.

<sup>8</sup> See proposed amendment to Rule 24.6, Days and Hours of Business.

result in delivery of cash on the business day following expiration. Vol Index options will be A.M.-settled.<sup>9</sup> The exercise settlement value will be determined by a Special Opening Quotations ("SOQ") of a Vol Index calculated from the sequence of opening prices of a single strip of options expiring 30 days after the settlement date. The opening price for any series in which there are is no trade shall be the average of that options' bid price and ask price as determined at the opening of trading.<sup>10</sup>

The exercise-settlement amount will be equal to the difference between the exercise-settlement value and the exercise price of the option, multiplied by \$100. When the last trading day is moved because of a CBOE holiday, the last trading day for expiring options will be the day immediately preceding the last regularly-scheduled trading day.

#### Position and Exercise Limits

For regular options trading, the Exchange is proposing to establish position limits for Vol Index options at 50,000 contracts on either side of the market and no more than 30,000 contracts in the nearest expiration month. CBOE believes that a 50,000 contract position limit is appropriate due to the fact that the options which are the underlying components for a Vol Index are among the most actively traded option classes currently listed. In determining compliance with these proposed position limits, Vol Index options will not be aggregated with the underlying exchange-traded fund or individual stock options. Exercise limits will be

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<sup>9</sup> See proposed amendment to Rule 24.9(a)(4) (adding Exchange-traded fund volatility indexes and Individual stock volatility indexes to the list of A.M.-settled index options approved for trading on the Exchange).

<sup>10</sup> See proposed amendment to Rule 24.9(a) (5) (revising rule to make "Volatility Index" options generic for purposes of this provision, which sets forth the method of determining the day that the exercise settlement value is calculated and of determining the expiration date and the last trading day for CBOE Volatility Index Options). The Exchange is also proposing to make technical changes to this rule provision as well.

the equivalent to the proposed position limits.<sup>11</sup> Vol Index options will be subject to the same reporting requirements triggered for other options dealt in on the Exchange.

For FLEX options trading, the Exchange is proposing that the position limits for FLEX Vol Index Options will be equal to the position limits for Non-FLEX Options on the same Vol Index. Similarly, the Exchange is proposing that the exercise limits for FLEX Vol Index Options will be equivalent to the position limits established pursuant to Rule 24.4. The proposed position and exercise limits for FLEX Vol Index Options are consistent with the treatment of position and exercise limits for Flex GVZ and other Flex Index Options. The Exchange is also proposing to amend subparagraph (4) to Rules 24A.7(d) and 24B.7(d) to provide that as long as the options positions remain open, positions in FLEX Vol Index Options that expire on the same day as Non-FLEX Vol Index Options, as determined pursuant to Rule 24.9(a)(5), shall be aggregated with positions in Non-FLEX Vol Index Options and shall be subject to the position limits set forth in Rules 4.11, 24.4, 24.4A and 24.4B, and the exercise limits set forth in Rules 4.12 and 24.5.

The Exchange is proposing to establish a Vol Index Hedge Exemption, which would be in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. The Exchange proposes to establish the following procedures and criteria which must be satisfied to qualify for a Vol Index hedge exemption:

- The account in which the exempt option positions are held ("hedge exemption account") has received prior Exchange approval for the hedge exemption specifying the maximum number of contracts which may be exempt under the proposed new Interpretation. The hedge exemption account has provided all information required

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<sup>11</sup> See proposed amendment to rule 24.5 and proposed new Interpretations and Policy .04 to rule 24.5.



on Exchange-approved forms and has kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two (2) business days or such other time period designated by the Department of Market Regulation furnish the Department of Market Regulation with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

- A hedge exemption account that is not carried by a CBOE member organization must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.
- The hedge exemption account maintains a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time as the execution of the exempt options positions, of a net long or short position in Equity-Based Volatility Index futures contracts or in options on Vol Index futures contracts, or long or short positions in Vol Index options, for which the underlying Vol Index is included in the same margin or cross-margin product group cleared at the Clearing Corporation as the Vol Index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.
- The exemption applies to positions in Vol Index options dealt in on the Exchange and is applicable to the unhedged value of the qualified portfolio. The unhedged value will be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the

- standard limit, the underlying market value (a) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (b) of any opposite side of the market positions in Vol Index futures, options on Vol Index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows—the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.
- Only the following qualified hedging transactions and positions will be eligible for purposes of hedging a qualified portfolio (i.e. futures and options) pursuant to the propose new Interpretation .01:
    - Long put(s) used to hedge the holdings of a qualified portfolio;
    - Long call(s) used to hedge a short position in a qualified portfolio;
    - Short call(s) used to hedge the holdings of a qualified portfolio; and
    - Short put(s) used to hedge a short position in a qualified portfolio.
  - The following strategies may be effected only in conjunction with a qualified stock portfolio:
    - A short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s)(a "collar"). Neither side of the collar transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 4.11 and proposed Rule

- 24.4C, a collar position will be treated as one (1) contract;
- A long put position coupled with a short put position overlying the same Vol Index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s) (a "debit put spread position"); and
  - A short call position accompanied by a debit put spread position, where the short call(s) expires with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Neither side of the short call, long put transaction can be in-the-money at the time the position is established. For purposes of determining compliance with Rules 4.11 and proposed Rule 24.4C, the short call and long put positions will be treated as one (1) contract.
- The hedge exemption account shall:
    - liquidate and establish options, their equivalent or other qualified portfolio products in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes.
    - liquidate any options prior to or contemporaneously with a decrease in the hedged value of the qualified portfolio which options would thereby be rendered excessive.
    - promptly notify the Exchange of any material change in the qualified portfolio which materially affects the unhedged value of the qualified portfolio.
  - If an exemption is granted, it will be effective at the time the decision is

communicated. Retroactive exemptions will not be granted.

#### Exchange Rules Applicable

Except as modified herein, the rules in Chapters I through XIX, XXIV, XXIVA, and XXIVB will equally apply to Vol Index options.

The Exchange is proposing that the margin requirements for Vol Index options be set at the same levels that apply to equity options under Exchange Rule 12.3. Margin of up to 100% of the current market value of the option, plus 20% of the underlying volatility index value must be deposited and maintained. The pertinent provisions of Rule 12.3, Margin Requirements, have been amended to reflect these proposed revisions. Additional margin may be required pursuant to Exchange Rule 12.10.

The Exchange hereby designates Vol Index options as eligible for trading as Flexible Exchange Options as provided for in Chapters XXIVA (Flexible Exchange Options) and XXIVB (FLEX Hybrid Trading System). The Exchange notes that Vol Index FLEX Options will only expire on business days that non-FLEX options on Vol Indexes expire. This is because the term "exercise settlement value" in Rules 24A.4(b)(3) and 24B.4(b)(3), *Special Terms for FLEX Index Options*, has the same meaning set forth in Rule 24.9(5). As is described earlier, the Exchange is proposing to amend Rule 24.9(a)(5) to provide that the exercise settlement value of Vol Index options for all purposes under CBOE Rules will be calculated as the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the month in which a Vol Index options expire.

#### Capacity

CBOE has analyzed its capacity and represents that it believes the Exchange and the Options Price Reporting Authority have the necessary systems capacity to handle the

additional traffic associated with the listing of new series that would result from the introduction of Vol Index options.

### Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the Exchange's other index options to monitor trading in Vol Index options. The Exchange further represents that these surveillance procedures shall be adequate to monitor trading in options on these volatility indexes. For surveillance purposes, the Exchange will have complete access to information regarding trading activity in the pertinent underlying securities.

### 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act<sup>12</sup> and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.<sup>13</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>14</sup> 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 the introduction of Vol Index options will attract order flow to the Exchange, increase the variety of listed options to investors, and provide a valuable hedging tool to investors.

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<sup>12</sup> 15 U.S.C. 78s(b)(1).

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 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

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2011-026 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-2011-026. 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 10:00 am and 3:00 pm. 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-2011-026 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.<sup>15</sup>

Dated: \_\_\_\_\_

Secretary

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<sup>15</sup> 17 CFR 200.30-3(a)(12).