SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56970; File No. SR-CBOE-2007-99)

December 14, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to a Delta Hedging Exemption From Equity Options Position Limits

On August 21, 2007, the Chicago Board Options Exchange, Incorporated (‘CBOE’ or ‘Exchange’) filed with the Securities and Exchange Commission (‘Commission’), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (‘Act’) and Rule 19b-4 thereunder, a proposed rule change to create a delta hedging exemption from equity options position limits. On October 4, 2007, the Exchange filed Amendment No. 1 to the proposed rule change. The Commission published the proposed rule change, as amended by Amendment No. 1, for comment in the Federal Register on October 15, 2007. On October 24, 2007, the Exchange filed Amendment No. 2 to the proposed rule change. The Commission received no comments on the proposed rule change. This order approves the proposed rule change as modified by Amendment Nos. 1 and 2.

4 In Amendment No. 2, CBOE made a technical revision to the proposal. This is a technical amendment and is not subject to notice and comment. In Amendment No. 2, CBOE noted that the effective date of the proposal will be February 1, 2008, or such later date as may be necessary to ensure completion of the required technology changes by the Options Clearing Corporation and the Securities Industry Automation Corporation.
Under the proposal, the Exchange would provide an exemption from equity options\(^5\) position and exercise limits\(^6\) for positions held by CBOE members and certain non-member affiliates\(^7\) that are “delta neutral”\(^8\) under a “permitted pricing model.”\(^9\) The options contract equivalent of the net delta\(^10\) of a hedged options position still would be subject to the position limits in Rule 4.11 (subject to the availability of any other position limit exemptions).\(^{11}\) A

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\(^5\) Equity options for purposes of this proposed rule change includes stock options and options on exchange-traded funds.

\(^6\) CBOE Rule 4.12 establishes exercise limits for an option at the same level as the option's position limit under Rule 4.11. Therefore, no changes are proposed to Rule 4.12.

\(^7\) The Commission notes that only those non-member affiliates identified in the definition of “permitted pricing model” would be eligible to rely on the delta hedging exemption. See infra note 9.

\(^8\) The term “delta neutral” would be defined in proposed Rule 4.11.04(c)(A) as referring to an equity option position that is hedged, in accordance with a permitted pricing model, by a position in the underlying security or one or more instruments relating to the underlying security, for the purpose of offsetting the risk that the value of the option position will change with incremental changes in the price of the security underlying the option position.

\(^9\) “Permitted pricing model” for purposes of this exemption would be a pricing model used by: (1) a member or its non-member affiliate, using a pricing model maintained and operated by the Options Clearing Corporation; (2) a member or its non-member affiliate subject to consolidated supervision by the Commission pursuant to Appendix E of Rule 15c3-1 under the Act (i.e., a consolidated supervised entity or “CSE”); (3) a financial holding company (“FHC”) or a company treated as an FHC under the Bank Holding Company Act of 1956, or its affiliate subject to consolidated holding company group supervision; (4) a Commission registered OTC derivatives dealer; and (5) a national bank under the National Bank Act. See proposed Rule 4.11.04(c)(C).

\(^10\) “Net delta” would be defined to mean, at any time, the number of shares (either long or short) required to offset the risk that the value of an equity option position will change with incremental changes in the price of the security underlying the option position. See proposed Rule 4.11.04(c)(B).

\(^11\) “Options contract equivalent of the net delta” would be defined to mean the net delta divided by the number of shares underlying the options contract. See proposed Rule 4.11.04(c)(B).

See proposed Rule 4.11.04(c)(B). The Commission notes that Rule 4.11.04 provides for multiple, independent hedge exemptions. Of course, to the extent that a position is used
member that intends to employ, or whose non-member affiliate intends to employ, this
exemption would be required to provide a written certification to CBOE stating that the member
and/or its affiliate will use a permitted pricing model. In addition, members that carry an
account that includes an equity option position for a non-member affiliate would be required to
obtain a written statement from the non-member affiliate confirming that the affiliate: (1) is
relying on this exemption; (2) will use only a permitted pricing model for purposes of calculating
the net delta of its option positions for purposes of this exemption; (3) will promptly notify the
member if it ceases to rely on this exemption; (4) authorizes the member, upon request, to
provide to the Exchange or the Options Clearing Corporation such information regarding
positions of the non-member affiliate as part of the Exchange's confirmation or verification of the
accuracy of the net delta calculation under this exemption; and (5) if the non-member affiliate is
using the Options Clearing Corporation model, has duly executed and delivered to the Exchange
such documents as the Exchange may require as a condition to reliance on this exemption.

Furthermore, any member would be required to report, in accordance with Rule 4.13, all
equity options positions (including those that are delta neutral) that are reportable under that rule,
and also would be required to report on its own behalf or on behalf of a designated aggregation
unit the net delta and options contract equivalent of the net delta of such positions for each

See proposed Rule 4.11.04(c)(E)(1) and (E)(3)(i).
See proposed Rule 4.11.04(c)(E)(3)(ii).
See proposed Rule 4.11.04(c)(D), which provides, under certain conditions, that the net
delta of an options position held by an entity entitled to rely on the exemption could be
calculated without regard to positions in or relating to the security underlying the option
position held by an affiliated entity or another trading unit within the same entity.
account that holds an equity option position subject to the delta hedging exemption in excess of the levels specified in Rule 4.11. Each member relying on the exemption would be required to retain, and undertake reasonable efforts to ensure that its non-member affiliates relying on the exemption retain, a list of the options, securities, and other instruments underlying each option position net delta calculation reported to the Exchange; and to produce such information to the Exchange upon request. In addition, the options positions of a non-member relying on the exemption would be required to be carried by a member with which it is affiliated.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange. In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires, among other things, that CBOE rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission has previously stated its support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.

provided that, among other things, no control relationship exists between such affiliates or trading units and the entity has designated in writing in advance the affiliates or trading units that are to be considered separate and distinct from each other.

15 See proposed Rule 4.11.04(c)(F).
16 See proposed Rule 4.11.04(c)(G).
17 See proposed Rule 4.11.04(c)(E)(2).
18 In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).
IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,\(^{21}\) that the proposed rule change (SR-CBOE-2007-99), as modified by Amendment Nos. 1 and 2, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.\(^{22}\)

Florence E. Harmon  
Deputy Secretary

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\(^{22}\) 17 CFR 200.30-3(a)(12).