

## OMB APPROVAL

OMB Number: 3235-0045  
Expires: June 30, 2010  
Estimated average burden  
hours per response.....38

Page 1 of 23

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
Form 19b-4

File No. SR - 2007 - 03

Amendment No. 1

Proposed Rule Change by Chicago Board Options Exchange  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial <input type="checkbox"/>	Amendment <input checked="" 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)	

Section 19(b)(3)(A) - Rule 19b-4



Section 19(b)(3)(B) - Rule 19b-4

**Description**

Provide a brief description of the proposed rule change (limit 250 characters).

**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 Jennifer Last Name Lamie  
Title Assistant General Counsel  
E-mail lamie@cboe.com  
Telephone (312) 786-7576 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 12/20/2007

By Jennifer M. Lamie

(Name)

Assistant General Counsel and Assistant Secretary

(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.

Jennifer-lamie-lamie@cboe.com

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

**Form 19b-4 Information**

[Add](#) [Remove](#) [View](#)

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**

[Add](#) [Remove](#) [View](#)

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**

[Add](#) [Remove](#) [View](#)

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**

[Add](#) [Remove](#) [View](#)

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**

[Add](#) [Remove](#) [View](#)

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**

[Add](#) [Remove](#) [View](#)

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**

[Add](#) [Remove](#) [View](#)

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

The Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) proposes to amend Rule 24.16, which is the Exchange’s rule applicable to the nullification and adjustment of transactions in index options, options on exchange-traded funds (“ETFs”) and options on HOLDing Company Depository ReceiptS (“HOLDRS”). The Exchange is proposing to amend the rule in order to: (i) modify the nullification and adjustment provisions for erroneous prints and erroneous quotes in the underlying; (ii) eliminate the nullification and adjustment provision for trades below intrinsic value; and (iii) modify the nullification provision for no bid series. Set forth below are proposed changes to the rule text, with additions represented by underscoring and deletions represented by [bracketing].

Chicago Board Options Exchange, Incorporated  
Rules

\* \* \* \* \*

Rule 24.16. Nullification and Adjustment of Transactions in Index Options,  
Options on ETFs and Options on HOLDRS

RULE 24.16. This Rule only governs the nullification and adjustment of transactions involving index options and options on ETFs or HOLDRS. Rule 6.25 governs the nullification and adjustment of transactions involving equity options. Paragraphs (a)(1)[,] and (5) [and (6)] of this Rule have no applicability to trades executed in open outcry.

(a) Trades Subject to Review

A member or person associated with a member may have a trade adjusted or nullified, as provided herein, if, in addition to satisfying the procedural requirements of paragraph (b) below, one of the following conditions is satisfied:

(1) – (2) No change.

(3) Erroneous Print in Underlying or Related Instrument: A trade resulting from an erroneous print disseminated [by the underlying market]in a designated underlying or related instrument which is later cancelled or corrected [by that underlying market] may be adjusted or nullified. In order to be adjusted or nullified, however, the trade must be the result of an erroneous print that is higher or lower than the average trade in the [underlying security]instrument during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for such [underlying security]instrument during the same period.

For purposes of this [Rule,]paragraph (3):

(i) The underlying or related instrument(s) (which may include the underlying or related ETF(s), HOLDERS(s) and/or index value(s), and/or related futures product(s)) and the relevant market(s) will be designated by the appropriate Exchange committee and announced to the membership via Regulatory Circular. To qualify for consideration as a “related instrument:” (A) the option class and related instrument must be derived from or designed to track the same underlying index; or (B) in the case of S&P 100-related options, the options class and related instrument must be derived from or designed to track the S&P 100 Index or the S&P 500 Index.

(ii) For purposes of an ETF, HOLDERS or futures product, the average trade in the underlying [security]or related instrument shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question). [For purposes of this Rule, t]The average quote width shall be determined by adding the quote widths of each separate quote during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).

(iii) For purposes of an index value, the above-references to “average trade” and “average quote width” shall mean the average index value and the index range. The average index value shall be determined by adding the index values reported during the four minute time period referenced above (excluding the index value in question) and dividing by the number of index values reported during such time period (excluding the index value in question). The index range shall be the difference between the highest and lowest index values during the four minute time period referenced above (excluding the index value in question).

(4) Erroneous Quote in Underlying or Related Instrument: A trade resulting from an erroneous quote in [the]a designated underlying [security]or related instrument may be adjusted or nullified. An erroneous quote occurs when the underlying [security]or related instrument has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying [security]or related instrument on the [primary]relevant market during the time period encompassing two minutes before and after the dissemination of such quote.

For purposes of this paragraph (4): The underlying or related instrument(s) (which may include the underlying or related ETF(s) and/or HOLDERS(s), and/or related futures products) and the relevant market(s) will be designated by the appropriate Exchange committee and announced to the membership via Regulatory Circular. To qualify for consideration as a “related instrument:” (i) the option class and related instrument must be derived from or designed to track the same underlying index; or (ii) in the case of S&P 100-related options, the options class and related instrument must be derived from or designed to track the S&P 100 Index or the S&P 500 Index.

[(5) Trades Below Intrinsic Value: An obvious pricing error will be deemed to occur when the transaction price of an equity option is more than \$0.10 below the intrinsic value of the same option (an option that trades at its intrinsic value is sometimes said to trade at

'parity'). Paragraph (6) shall not apply to transactions occurring during the last two minutes of the trading day.]

[(i) Definition of Intrinsic Value: For purposes of this Rule, the intrinsic value of an equity call option equals the value of the underlying stock (measured from the bid or offer as described below) minus the strike price, and the intrinsic value of an equity put option equals the strike price minus the value of the underlying stock (measured from the bid or offer as described below), provided that in no case is the intrinsic value of an option less than zero. In the case of purchasing call options and selling put options, intrinsic value is measured by reference to the bid in the underlying security, and in the case of purchasing put options and selling call options, intrinsic value is measured by reference to the offer in the underlying security.]

[(6)](5) No Bid Series: Electronic transactions in series quoted no bid on the Exchange will be nullified provided:

(i) the bid in that series immediately preceding the execution was, and for five seconds prior to the execution remained, zero; and

(ii) at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid and offered at the same price or lower as that series at the time of execution.

For purposes of this subparagraphs (a) (5) (i) and (a)(5)(ii), bids and offers of the parties to the subject trade that are in any of the series in the same options class will not be considered. In addition, each group of series in an options class with a non-standard deliverable will be treated as a separate options class.

#### (b) Procedures for Reviewing Transactions

(1) Notification: Any member or person associated with a member that believes it participated in a transaction that may be adjusted or nullified in accordance with paragraph (a) must notify any Trading Official promptly but not later than fifteen (15) minutes after the execution in question. For transactions occurring after 2:45 p.m. (CT), notification must be provided promptly but not later than fifteen (15) minutes after the close of trading of that security on CBOE. Absent unusual circumstances, Trading Officials shall not grant relief under this Rule unless notification is made within the prescribed time periods.

In the absence of unusual circumstances, Trading Officials (either on their own motion or upon request of a member) must initiate action pursuant to paragraph (a)[(3)](2) above within sixty (60) minutes of the occurrence of the verifiable disruption or malfunction. When Trading Officials take action pursuant to paragraph (a)[(3)](2), the members involved in the transaction(s) shall receive verbal notification as soon as is practicable.

(2) No change.

#### (c) Adjustments and Nullifications

(1) No change.

(2) Transactions between CBOE Market-Makers pursuant to paragraphs (a)(2) – (a)[(5)](4) shall be nullified.

(3) Transactions involving at least one non-CBOE Market-Maker pursuant to paragraphs (a)(1) through (a)[(5)](4) will be adjusted provided the adjusted price does not violate the non-CBOE Market-Maker's limit price. Otherwise, the transaction will be nullified. [With respect to Rule 24.16(a)(1)(ii)(B) – (a)(4), t]The price to which a transaction

shall be adjusted shall be the National Best Bid (Offer) immediately following the erroneous transaction with respect to a sell (buy) order entered on the Exchange. For ROS or HOSS transactions, the price to which a transaction shall be adjusted shall be based on the first non-erroneous quote after the erroneous transaction on CBOE. [With respect to Rule 24.16(a)(5), the transaction shall be adjusted to a price that is \$0.10 under parity.]

(d) No change.

(e) No change.

. . . Interpretations and Policies:

.01 - .02 No change.

\* \* \* \* \*

Item 2.        Procedures of the Self-Regulatory Organization

(a)        The CBOE's Office of the Chairman pursuant to delegated authority approved the proposed rule change on February 20, 2007. 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 Jennifer Lamie, (312) 786-7576.

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

(a)        Purpose

Amendment 1, which replaces the original filing in its entirety, makes certain revisions in order to simplify and clarify the proposed procedures for determining erroneous "no bid series" transactions, as well as erroneous prints and quotes in underlying or related instruments.

The Exchange is proposing to make various amendments to Rule 24.16, which is its obvious error rule pertaining to index options, options on ETFs and options on HOLDRS. First, the proposal would modify the rule's provisions pertaining to erroneous prints and erroneous quotes in the underlying. Currently, the rule provides that a trade resulting from an erroneous print disseminated in the underlying market which is later cancelled or

corrected by that underlying market may be adjusted or nullified.<sup>1</sup> Similarly, the rule also provides that a trade resulting from an erroneous quote in the underlying security may be adjusted or nullified.<sup>2</sup> Under the revised rule, the appropriate Exchange committee would identify particular underlying or related instrument(s) that would be used to determine an erroneous print or quote and would also identify the relevant market(s) trading the underlying or related instrument to which the Exchange would look for purposes of applying the obvious error analysis. The underlying or related instrument(s) may include the underlying or related ETF(s), HOLDRS(s), and/or index value(s),<sup>3</sup> and/or related futures product(s),<sup>4</sup> and the relevant underlying market(s) may include one or more markets. The underlying or related instrument(s) and relevant market(s) will be designated by the appropriate Exchange committee and announced to the membership via Regulatory Circular. For a particular ETF,

---

<sup>1</sup> Under the current rule, to be adjusted or nullified, the trade must be the result of an erroneous print that is higher or lower than the average trade in the underlying security during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for such underlying security during the same period. See Rule 24.16(a)(3).

<sup>2</sup> Under the current rule, an erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying security on the primary market during the time period encompassing two minutes before and after the dissemination of such quote. See Rule 24.16(a)(4).

<sup>3</sup> An “index value” is the value of an index as calculated and reported by the index’s reporting authority. Use of an index value would only be applicable for purposes of identifying an erroneous print in the underlying (and not an erroneous quote). See proposed changes to Rule 24.16(a)(3).

<sup>4</sup> To confirm, the Exchange is only proposing that it may designate underlying or related ETF(s), HOLDRS(s), and/or index value(s), and/or related futures product(s). The Exchange is not proposing to designate any of the individual underlying stocks (or related options or futures on any of the individual underlying stocks) that comprise a particular ETF, HOLDR or index. (Any such proposal would be the subject of a separate rule filing.)

HOLDERS, index value and/or futures product to qualify for consideration as a “related instrument,” the revised rule requires that: (i) the option class and related instrument must be derived from or designed to track the same underlying index; or (ii) in the case of S&P 100-related options, the options class and related instrument must be derived from or designed to track the S&P 100 Index or the S&P 500 Index.

Thus, as an example for illustrative purposes only, for options on the Nasdaq 100 Index Tracking Stock (ETF option symbol “QQQ”), the appropriate Exchange committee may determine to designate the underlying Nasdaq 100 ETF and the primary market where it trades, as well as a related futures product overlying the Nasdaq 100 Index and the primary market where that futures product trades, as the instruments that would be considered by the Exchange in determining whether an erroneous print or an erroneous quote has occurred that would form the basis for an adjustment or nullification to a transaction in the related options.<sup>5</sup>

---

<sup>5</sup> Using this example, under the revised rule, the designated instruments and markets would be announced by Regulatory Circular. Thereafter, for a transaction in the QQQ options class to be adjusted or nullified due to an erroneous print in an underlying or related instrument that is later cancelled or corrected, the trade must be the result of: (i) an erroneous print in the underlying Nasdaq 100 ETF that is higher or lower than the average trade in the underlying Nasdaq 100 ETF on the primary market during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the ETF during the same period, or (ii) an erroneous print in the designated futures product overlying the Nasdaq 100 Index that is higher or lower than the average trade in the designated futures product on the designated market during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the futures product during the same period. See proposed changes to Rule 24.16(a)(3). For an options transaction to be adjusted or nullified due to an erroneous quote in an underlying or related instrument, an erroneous quote would occur when: (i) the underlying Nasdaq 100 ETF has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such ETF on the primary market during the time period encompassing two minutes before and after the dissemination of such quote, or (ii) the designated futures product overlying the Nasdaq 100 Index has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such futures product on the designated



As another example for illustrative purposes only, for the Exchange's class of options on the S&P 100 Index (index option symbol "OEX"), the appropriate Exchange committee may determine to designate the following underlying or related instruments: the S&P 100 Index value as calculated and reported by Standard and Poor's (the index's reporting authority), the S&P Depository Receipts traded on the American Stock Exchange, and the S&P 500 futures contract traded on the Chicago Mercantile Exchange.<sup>6</sup>

The proposed change is intended to address member feedback and to provide relief in those scenarios where an erroneous options transaction may occur as the result of an erroneous print or erroneous quote in markets other than the primary market for the underlying security. The Exchange believes the proposed change recognizes that market participants trading in the overlying index, ETF and HOLDRS options may base their options

---

market during the period encompassing two minutes before and after the dissemination of such quote. See proposed changes to Rule 24.16(a)(4).

<sup>6</sup> Using this example, under the revised rule, the designated instruments and markets would be announced by Regulatory Circular. Thereafter, for a transaction in the OEX options class to be adjusted or nullified due to an erroneous print in an underlying or related instrument that is later cancelled or corrected, the trade must be the result of: (i) an erroneous report of the underlying S&P 100 Index value that is higher or lower than the average price in the index during a two-minute period before and after the erroneous report by an amount at least five times higher or lower than the difference between the highest and lowest index values during the same period or (ii) an erroneous print in the S&P Depository Receipts or S&P 500 futures contract, as applicable, that is higher or lower than the average trade in the designated instrument during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the designated instrument during the same period. See proposed changes to Rule 24.16(a)(3). To be adjusted or nullified due to an erroneous quote in the underlying or related instrument, an erroneous quote would occur when the S&P Depository Receipts or S&P 500 futures contract, as applicable, has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such instrument on the relevant market during the time period encompassing two minutes before and after the dissemination of such quote. See proposed changes to Rule 24.16(a)(4) and note 3 supra.

prices on trading in various products and markets, while maintaining reasonable and objective criteria for these types of obvious error reviews.

Second, the proposal would eliminate the nullification and adjustment provision for trades below intrinsic value. Rule 24.16(a)(5) currently states that an obvious pricing error will be deemed to have occur when the transaction price of an option series is more than \$0.10 below the intrinsic value of the same option. The purpose of deleting this provision is to account for circumstances under which options are correctly priced \$0.10 or more below the intrinsic value. For example, this might occur in options with underlying securities that are hard-to-borrow, extremely volatile issues where one market participant seeks to transfer the risk of selling or buying a security to other market participants by trading options, and options that are European-style exercise thus preventing exercise prior to expiration. Additionally, the Exchange notes that elimination of this provision is consistent with the Exchange's current rule for equity options, which does not have an obvious error review for trades below intrinsic value.

Third, the proposal would modify the nullification provision for no bid series. Currently, the rule simply provides that electronic transactions in series that are quoted no bid on the Exchange are subject to nullification provided that at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid at the time of execution. Under the revised rule, additional criteria and clarifying language would be added. Specifically, an electronic transaction in a series quoted no bid on the Exchange would be subject to nullification provided: (i) the bid in that series immediately preceding the execution was, and for five (5) seconds prior to the execution remained, zero and (ii) at least one strike price below (for calls) or above (for puts) in the same options class was quoted no

bid and offered at the same price or lower as that series at the time of execution. Thus, for example, if a trade occurs in the ABC 45 call option series when the series was quoted \$0.00 - \$0.10, the trade may be nullified if (i) the bid was at \$0.00 for at least five (5) seconds prior to the execution and (ii) at least one call option series in ABC with a strike below 45 (e.g., the ABC 30, 35 or 40 call option series) had a bid of \$0.00 and an offer of \$0.10 or less at the time of execution.

The revised no bid provision would provide that, when determining the Exchange's quotes in the relevant series, bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered. The revised rule would also provide that each group of series in an options class with a non-standard deliverable will be treated as a separate options class. Thus, for example, if due to a reorganization certain of the series in the ABC option class have a deliverable of 150 shares per options contract (as compared to the standard 100 shares per option contract), all ABC option series that are subject to the 150 contract delivery requirements would be considered separately from the ABC option series that are subject to the 100 contract delivery requirements for purposes of applying the no bid provision. Finally, the revised rule would clarify that the no bid provision is intended to apply to series quoted no bid on the Exchange (as opposed to series for which the national best bid is quoted no bid).<sup>7</sup>

The proposed changes to the no bid provision are intended to address the Exchange's experience in applying the provision to particular trading scenarios that have occurred. The

---

<sup>7</sup> Consistent with the existing provisions, for a nullification to be granted, any member or person associated with a member that believes it participated in a transaction that falls within the no bid series parameters must also satisfy the notification procedures set forth in paragraph (b) of Rule 24.16.

Exchange believes that the additional criteria and clarifications are reasonable and objective, and would serve to better identify instances where the no bid provision is intended to apply.

(b) Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the "Act")<sup>8</sup> and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.<sup>9</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>10</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.

Item 4. 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.

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

The Exchange neither solicited nor received comments on the proposal.

Item 6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time-period for Commission action.

---

<sup>8</sup> 15 U.S.C. 78s(b)(1).

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

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 or By-Laws of Another Self-Regulatory Organization or of the Commission

Not applicable.

Item 9. Exhibits

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

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34- ; File No. SR-CBOE-2007-03)

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

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Amending its Obvious Error Rule for Options on Indices, ETFs and HOLDRS

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 \_\_\_\_\_, 2007, the Chicago Board Options Exchange, Incorporated (the “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

The Exchange proposes to amend Rule 24.16, which is the Exchange’s rule applicable to the nullification and adjustment of transactions in index options, options on exchange-traded funds (“ETFs”) and options on HOLding Company Depository Receipts (“HOLDRS”). The Exchange is proposing to amend the rule in order to: (i) modify the nullification and adjustment provisions for erroneous prints and erroneous quotes in the underlying; (ii) eliminate the nullification and adjustment provision for trades below intrinsic value; and (iii) modify the nullification provision for no bid series. The text of the proposed

---

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

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

rule change is available on the Exchange's website (<http://www.cboe.org/legal>), at the Office of the Secretary, CBOE 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

Amendment 1, which replaces the original filing in its entirety, makes certain revisions in order to simplify and clarify the proposed procedures for determining erroneous "no bid series" transactions, as well as erroneous prints and quotes in underlying or related instruments.

The Exchange is proposing to make various amendments to Rule 24.16, which is its obvious error rule pertaining to index options, options on ETFs and options on HOLDRS. First, the proposal would modify the rule's provisions pertaining to erroneous prints and erroneous quotes in the underlying. Currently, the rule provides that a trade resulting from an erroneous print disseminated in the underlying market which is later cancelled or corrected by that underlying market may be adjusted or nullified.<sup>3</sup> Similarly, the rule also

---

<sup>3</sup> Under the current rule, to be adjusted or nullified, the trade must be the result of an erroneous print that is higher or lower than the average trade in the underlying security during a two-minute period before and after the erroneous print by an amount

provides that a trade resulting from an erroneous quote in the underlying security may be adjusted or nullified.<sup>4</sup> Under the revised rule, the appropriate Exchange committee would identify particular underlying or related instrument(s) that would be used to determine an erroneous print or quote and would also identify the relevant market(s) trading the underlying or related instrument to which the Exchange would look for purposes of applying the obvious error analysis. The underlying or related instrument(s) may include the underlying or related ETF(s), HOLDRS(s), and/or index value(s),<sup>5</sup> and/or related futures product(s),<sup>6</sup> and the relevant underlying market(s) may include one or more markets. The underlying or related instrument(s) and relevant market(s) will be designated by the appropriate Exchange committee and announced to the membership via Regulatory Circular. For a particular ETF, HOLDRS, index value and/or futures product to qualify for consideration as a “related instrument,” the revised rule requires that: (i) the option class and related instrument must be derived from or designed to track the same underlying index; or (ii) in the case of S&P 100-

---

at least five times greater than the average quote width for such underlying security during the same period. See Rule 24.16(a)(3).

- <sup>4</sup> Under the current rule, an erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying security on the primary market during the time period encompassing two minutes before and after the dissemination of such quote. See Rule 24.16(a)(4).
- <sup>5</sup> An “index value” is the value of an index as calculated and reported by the index’s reporting authority. Use of an index value would only be applicable for purposes of identifying an erroneous print in the underlying (and not an erroneous quote). See proposed changes to Rule 24.16(a)(3).
- <sup>6</sup> To confirm, the Exchange is only proposing that it may designate underlying or related ETF(s), HOLDRS(s), and/or index value(s), and/or related futures product(s). The Exchange is not proposing to designate any of the individual underlying stocks (or related options or futures on any of the individual underlying stocks) that comprise a particular ETF, HOLDR or index. (Any such proposal would be the subject of a separate rule filing.)



related options, the options class and related instrument must be derived from or designed to track the S&P 100 Index or the S&P 500 Index.

Thus, as an example for illustrative purposes only, for options on the Nasdaq 100 Index Tracking Stock (ETF option symbol “QQQ”), the appropriate Exchange committee may determine to designate the underlying Nasdaq 100 ETF and the primary market where it trades, as well as a related futures product overlying the Nasdaq 100 Index and the primary market where that futures product trades, as the instruments that would be considered by the Exchange in determining whether an erroneous print or an erroneous quote has occurred that would form the basis for an adjustment or nullification to a transaction in the related options.<sup>7</sup>

As another example for illustrative purposes only, for the Exchange’s class of options on the S&P 100 Index (index option symbol “OEX”), the appropriate Exchange committee

---

<sup>7</sup> Using this example, under the revised rule, the designated instruments and markets would be announced by Regulatory Circular. Thereafter, for a transaction in the QQQ options class to be adjusted or nullified due to an erroneous print in an underlying or related instrument that is later cancelled or corrected, the trade must be the result of: (i) an erroneous print in the underlying Nasdaq 100 ETF that is higher or lower than the average trade in the underlying Nasdaq 100 ETF on the primary market during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the ETF during the same period, or (ii) an erroneous print in the designated futures product overlying the Nasdaq 100 Index that is higher or lower than the average trade in the designated futures product on the designated market during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the futures product during the same period. See proposed changes to Rule 24.16(a)(3). For an options transaction to be adjusted or nullified due to an erroneous quote in an underlying or related instrument, an erroneous quote would occur when: (i) the underlying Nasdaq 100 ETF has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such ETF on the primary market during the time period encompassing two minutes before and after the dissemination of such quote, or (ii) the designated futures product overlying the Nasdaq 100 Index has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such futures product on the designated market during the period encompassing two minutes before and after the dissemination of such quote. See proposed changes to Rule 24.16(a)(4).

may determine to designate the following underlying or related instruments: the S&P 100 Index value as calculated and reported by Standard and Poor's (the index's reporting authority), the S&P Depository Receipts traded on the American Stock Exchange, and the S&P 500 futures contract traded on the Chicago Mercantile Exchange.<sup>8</sup>

The proposed change is intended to address member feedback and to provide relief in those scenarios where an erroneous options transaction may occur as the result of an erroneous print or erroneous quote in markets other than the primary market for the underlying security. The Exchange believes the proposed change recognizes that market participants trading in the overlying index, ETF and HOLDRS options may base their options prices on trading in various products and markets, while maintaining reasonable and objective criteria for these types of obvious error reviews.

Second, the proposal would eliminate the nullification and adjustment provision for trades below intrinsic value. Rule 24.16(a)(5) currently states that an obvious pricing error

---

<sup>8</sup> Using this example, under the revised rule, the designated instruments and markets would be announced by Regulatory Circular. Thereafter, for a transaction in the OEX options class to be adjusted or nullified due to an erroneous print in an underlying or related instrument that is later cancelled or corrected, the trade must be the result of: (i) an erroneous report of the underlying S&P 100 Index value that is higher or lower than the average price in the index during a two-minute period before and after the erroneous report by an amount at least five times higher or lower than the difference between the highest and lowest index values during the same period or (ii) an erroneous print in the S&P Depository Receipts or S&P 500 futures contract, as applicable, that is higher or lower than the average trade in the designated instrument during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for the designated instrument during the same period. See proposed changes to Rule 24.16(a)(3). To be adjusted or nullified due to an erroneous quote in the underlying or related instrument, an erroneous quote would occur when the S&P Depository Receipts or S&P 500 futures contract, as applicable, has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such instrument on the relevant market during the time period encompassing two minutes before and after the dissemination of such quote. See proposed changes to Rule 24.16(a)(4) and note 5 supra.

will be deemed to have occur when the transaction price of an option series is more than \$0.10 below the intrinsic value of the same option. The purpose of deleting this provision is to account for circumstances under which options are correctly priced \$0.10 or more below the intrinsic value. For example, this might occur in options with underlying securities that are hard-to-borrow, extremely volatile issues where one market participant seeks to transfer the risk of selling or buying a security to other market participants by trading options, and options that are European-style exercise thus preventing exercise prior to expiration. Additionally, the Exchange notes that elimination of this provision is consistent with the Exchange's current rule for equity options, which does not have an obvious error review for trades below intrinsic value.

Third, the proposal would modify the nullification provision for no bid series. Currently, the rule simply provides that electronic transactions in series that are quoted no bid on the Exchange are subject to nullification provided that at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid at the time of execution. Under the revised rule, additional criteria and clarifying language would be added. Specifically, an electronic transaction in a series quoted no bid on the Exchange would be subject to nullification provided: (i) the bid in that series immediately preceding the execution was, and for five (5) seconds prior to the execution remained, zero and (ii) at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid and offered at the same price or lower as that series at the time of execution. Thus, for example, if a trade occurs in the ABC 45 call option series when the series was quoted \$0.00 - \$0.10, the trade may be nullified if (i) the bid was at \$0.00 for at least five (5) seconds prior

to the execution and (ii) at least one call option series in ABC with a strike below 45 (e.g., the ABC 30, 35 or 40 call option series) had a bid of \$0.00 and an offer of \$0.10 or less at the time of execution.

The revised no bid provision would provide that, when determining the Exchange's quotes in the relevant series, bids and offers of the parties to the subject trade that are in any of the series in the same options class shall not be considered. The revised rule would also provide that each group of series in an options class with a non-standard deliverable will be treated as a separate options class. Thus, for example, if due to a reorganization certain of the series in the ABC option class have a deliverable of 150 shares per options contract (as compared to the standard 100 shares per option contract), all ABC option series that are subject to the 150 contract delivery requirements would be considered separately from the ABC option series that are subject to the 100 contract delivery requirements for purposes of applying the no bid provision. Finally, the revised rule would clarify that the no bid provision is intended to apply to series quoted no bid on the Exchange (as opposed to series for which the national best bid is quoted no bid).<sup>9</sup>

The proposed changes to the no bid provision are intended to address the Exchange's experience in applying the provision to particular trading scenarios that have occurred. The Exchange believes that the additional criteria and clarifications are reasonable and objective, and would serve to better identify instances where the no bid provision is intended to apply.

---

<sup>9</sup> Consistent with the existing provisions, for a nullification to be granted, any member or person associated with a member that believes it participated in a transaction that falls within the no bid series parameters must also satisfy the notification procedures set forth in paragraph (b) of Rule 24.16.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act<sup>10</sup> and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.<sup>11</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>12</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.

### 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 35 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

---

<sup>10</sup> 15 U.S.C. 78s(b)(1).

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

<sup>12</sup> 15 U.S.C. 78f(b)(5).

(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-2007-03 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-CBOE-2007-03. 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-2007-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

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

Nancy M. Morris  
Secretary

---

<sup>13</sup> 17 CFR 200.30-3(a)(12).