

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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Form 19b-4 Information

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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

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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.

1. Text of Proposed Rule Change

(a) Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) proposes to (i) expand the delta hedging exemption available for equity options position limits, (ii) amend the reporting requirements applicable to members relying on the delta hedging exemption, and (iii) adopt a delta hedging exemption from certain index options position limits. The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Exchange's Office of the Chairman, pursuant to delegated authority, on February 23, 2010. No further action is required. CBOE will announce the effective date of the proposed rule change in a regulatory circular to be published no later than 60 days after Commission approval. The effective date shall be no later than 30 days after publication of the regulatory circular.

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

(a) Purpose

I. Expansion of Delta-Based Equity Hedge Exemption

On December 14, 2007,¹ the Commission approved a proposed rule change establishing an exemption from equity options position and exercise limits for positions held by CBOE members, and certain of their affiliates, that are “delta neutral”² under a “permitted pricing model”³, subject to certain conditions (“Exemption”).

¹ See Securities Exchange Act Release No. 56970 (December 14, 2007), 72 FR 72428 (December 20, 2007). The exemption was extended to certain customers whose accounts are carried by a member. See Securities Exchange Act Release No. 60555 (August 21, 1009) 74 FR 43741 (August 27, 2009).

² The term "delta neutral" is defined in 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 “options contract equivalent of the net delta” of a hedged equity option position is subject to the position limits under Rule 4.11, subject to the availability of other exemptions.⁴ Currently, the Exemption only is available for securities that directly underlie the applicable option position. This means that with respect to options on exchange-traded funds (“ETF options”), index options overlying the same index on which the ETF is based currently cannot be combined with the ETF options to calculate a net delta for purposes of the Exemption.

Many ETF options overlie exchange-traded funds that track the performance of an index. For example, options on Standard & Poor's Depository Receipts (“SPY”) track the performance of the S&P 500 index. Market participants often hedge SPY options with options on the S&P 500 Index (“SPX options”) or with other financial instruments based on the S&P 500 Index for risk management purposes. The Exchange believes that in order for eligible market participants to more fully benefit from the Exemption as it relates to ETF options, securities and other instruments that are based on the same underlying ETF or the same index on which the ETF is based should also be included in any determination of an ETF option position's net delta or whether the options position is hedged delta neutral.⁵

Accordingly, the Exchange proposes to expand the Exemption by amending Rule 4.11.04(c)(A) to permit equity option positions for which the underlying security is an ETF that is based on the same index as an index option to be combined with an index option position for calculation of the delta-based equity hedge exemption. The proposed rule would allow financial products such as securities index options, index futures, and options on index futures to be included along with the ETF in an equity option's net delta calculation. So for example, the

the option position will change with incremental changes in the price of the security underlying the option position.

³ Permitted pricing model is defined in Rule 4.11.04(c)(C).

⁴ The term “options contract equivalent of the net delta” is defined in Rule 4.11.04(c)(B) as the net delta divided by the number of shares underlying the option contract. The term “net delta” is defined in the same rule 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, as determined in accordance with a permitted pricing model.

proposed rule would allow SPY options to be hedged not only with SPY shares, but with S&P 500 options, S&P 500 futures, options on S&P 500 futures or any other instrument that tracks the performance of or is based on the S&P 500 index. This would be accomplished by including such positions with a related index option position in accordance with the Delta-Based Index Hedge Exemption rule proposed below.

Index options and equity options (i.e., ETF options) that are eligible to be combined for computing a delta-based hedge exemption, along with all securities and/or other instruments that are based on or track the performance of the same underlying security or index, will be grouped and the net delta and options contract equivalent of the net delta will be calculated for each respective option class based on offsets realized from the grouping as a whole.

The Exchange proposes to amend the definition of “net delta” in Rule 4.11.04(c)(B) to mean, at any time, the number of shares and/or other units of trade⁶ (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, as determined in accordance with a permitted pricing model. The Exchange proposes to amend the definition of the “option contract equivalent of the net delta” to mean the net delta divided by the number of shares that equate to one option contract on a delta basis.⁷

II. Reporting Requirement

Rule 4.11.04(c)(F) sets forth the reporting requirements applicable to CBOE members who rely on the Exemption. The Exchange proposes to amend Rule 4.11.04(c)(F) to exempt from

⁵ However, this would not include baskets of securities for purposes of the Exemption.

⁶ “Other units of trade” would include, for example, options or futures contracts hedging the relevant option position. When determining whether an ETF option hedged with other instruments such as ETF or index options is delta neutral, the relative size of the ETF option when compared to the other product is taken into consideration. For example, SPX options are ten (10) times larger than SPY options thus 1 SPX delta is equivalent to .10 SPY deltas.

⁷ The Exchange also proposes to amend Rule 4.11.04(c)(C)(2) to clarify that there is no longer a consolidated supervision program by the SEC pursuant to Appendix E of Rule 15c3-1 of the Act.

the reporting requirements Exchange Market-Makers and Designated Primary Market-Makers (“DPMs”) relying on the Exemption who use the Options Clearing Corporation (“OCC”) pricing model, because Market-Maker and DPM position and delta information can be accessed through the Exchange’s market surveillance systems. This proposed exemption is consistent with similar exemptions from the reporting requirements under Rule 4.13 and those applicable to broad-based index options and FLEX options.⁸

III. Delta-Based Index Hedge Exemption

Most index options traded on the Exchange are subject to position and exercise limits, as provided under CBOE Rules 24.4, 24.4A and 24.4B.⁹ Certain broad-based index options are not subject to position and exercise limits.¹⁰ Position limits are imposed, generally, to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the holder of the options position.

Index options are often used by market participants such as institutional investors to hedge large portfolios. Exchange rules include hedge exemptions to allow certain positions in index options in excess of the applicable standard position limit if hedged with an Exchange-approved qualified portfolio.¹¹ Under Rule 24.4.01(c) (broad-based index hedge exemption), a qualified portfolio may consist of common stocks or securities readily convertible to common stock, and/or index futures contracts, options on index futures contracts, or long or short positions in index options or index warrants that meet certain standards. Under Rule 24.4A.01(a) (industry index hedge exemption), a qualified portfolio may consist only of underlying component stocks or in securities readily convertible to such component stocks. In the case of both hedge

⁸ See Rules 4.13(b), 24.4.03 and 24A.7(b) and (c).

⁹ Rules 24.4, 24.4A and 24.4B provide position limits for broad-based index options, industry index options and micro narrow-based index options, respectively.

¹⁰ Broad-based index options not subject to position and exercise limits are DJX, OEX, XEO, NDX, RUT, VIX, VXN, VXD and SPX. See CBOE Rules 24.4(a) and 24.5.

¹¹ See Interpretation and Policy .01 to Rule 24.4 (broad-based index hedge exemption) and Interpretation and Policy .01 to Rule 24.4A (industry index hedge exemption).

exemptions, the maximum size of the exempt position is set at a specified maximum number of contracts.

The Exchange believes that any limit on the ability of market participants to use index options to hedge their portfolios exposes market participants to unnecessary risk on the unhedged portion of their portfolios. The Exchange proposes to adopt a delta-based exemption from index option position and exercise limits that is substantially similar to the delta-based equity hedge exemption under Rule 4.11.04(c). A delta-based index hedge exemption would provide market participants the ability to accumulate an unlimited number of index options contracts provided that such contracts are properly delta hedged in accordance with the requirements of the exemption.

Proposed Exemption. The Exchange proposes to adopt an exemption from index options position and exercise limits¹² for positions held by CBOE members and certain of their affiliates, and customers that are "delta neutral" (as defined below) under a "permitted pricing model" (as defined below), subject to certain conditions ("Index Exemption"). The Index Exemption under proposed Rule 24.4.05 would also apply to industry index options under proposed Rule 24.4A.03.

The term "delta neutral" is defined in proposed Rule 24.4.05(A) as referring to an index option position that is hedged, in accordance with a permitted pricing model, by a position in one or more correlated instruments for the purpose of offsetting the risk that the value of the option position will change with incremental changes in the value of the underlying index. Correlated instruments would be defined to mean securities and/or other instruments that track the performance of or are based on the same underlying index as the index underlying the option position. These definitions would allow financial products such as ETF options, index futures,

¹² Exchange Rule 24.5 establishes exercise limits for an index option at the same level as the index option's position limit under index options position limit rules, therefore no changes are proposed to Rule 24.5.

options on index futures and ETFs that track the performance of or are based on the same underlying index to be included in an index option's net delta calculation.¹³

Any index option position that is not delta neutral would be subject to position and exercise limits, subject to the availability of other exemptions. Only the "options contract equivalent of the net delta" of such position would be subject to the appropriate position limit.¹⁴

In addition, members could not use the same positions in correlated instruments in connection with more than one hedge exemption. Therefore, a position in correlated instruments used as part of a delta hedging strategy could not also serve as the basis for any other index hedge exemption.

Permitted Pricing Model. Under the proposed rule, the calculation of the delta for any index option position, and the determination of whether a particular index option position is hedged delta neutral, must be made using a permitted pricing model. A "permitted pricing model" is defined in proposed Rule 24.4.05(C) to have the same meaning as defined in Rule 4.11.04(c)(C), namely, the pricing model maintained and operated by OCC and the pricing models used by (i) a member or its affiliate subject to consolidated supervision by the SEC or pursuant to Appendix E of SEC Rule 15c3-1; (ii) 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;¹⁵ (iii) an SEC registered OTC derivatives

¹³ See Supra footnote 5.

¹⁴ Under proposed Rule 24.4.05(B), the term "options contract equivalent of the net delta" is defined as the net delta divided by units of trade that equate to one option contract on a delta basis, and the term "net delta" is defined as, at any time, the number of shares and/or other units of trade (either long or short) required to offset the risk that the value of an index option position will change with incremental changes in the value of the underlying index, as determined in accordance with a permitted pricing model.

¹⁵ The pricing model of an FHC or of an affiliate of an FHC would have to be consistent with: (i) the requirements of the Board of Governors of the Federal Reserve System ("Fed"), as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Fed, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group; or (ii) the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company's principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where "principal regulator" means a

dealer;¹⁶ and (iv) a national bank.¹⁷ Customers seeking to use the delta-based index hedge exemption could only hedge their position in accordance with the OCC model.

Aggregation of Accounts. Members, non-member affiliates and customers relying on the Index Exemption would be required to ensure that the permitted pricing model is applied to all positions in correlated instruments hedging the relevant option position that are owned or controlled by the member, or its affiliates.

However, the net delta of an index option position held by an entity entitled to rely on the Index Exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in correlated instruments held by an affiliated entity or by another trading unit within the same entity, provided that: (i) the entity demonstrates to the Exchange's satisfaction that no control relationship, as defined in Rule 4.11.03, exists between such affiliates or trading units, and (ii) the entity has provided the Exchange written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of the Index Exemption.¹⁸ The Exchange has set forth in Regulatory Circular RG08-12 the conditions under which it will deem no control relationship to exist between affiliated broker-dealers and between separate and distinct trading units within the same broker-dealer.

member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company – provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group. See subparagraph (C) of proposed Rule 24.4.05, which incorporates Rule 4.11.04(c)(C).

¹⁶ The pricing model of an SEC registered OTC derivatives dealer would have to be consistent with the requirements of Appendix F to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder. Only an OTC derivatives dealer and no other affiliated entity (including a member) would be able to rely on this part of the Exemption. See subparagraph (C) of proposed Rule 24.4.05, which incorporates Rule 4.11.04(c)(C).

¹⁷ The pricing model of a national bank would have to be consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency. Only a national bank and no other affiliated entity (including a member) would be able to rely on this part of the Exemption. See subparagraph (C) of proposed Rule 24.4.05, which incorporates Rule 4.11.04(c)(C).

Any member, non-member affiliate or customer relying on the Index Exemption must designate, by prior written notice to the Exchange, each trading unit or entity whose options positions are required by Exchange rules to be aggregated with the options positions of such member, non-member affiliate or customer relying on the Index Exemption for purposes of compliance with Exchange position or exercise limits.¹⁹

Obligations of Members and Affiliates. Any member relying on the Index Exemption would be required to provide a written certification to the Exchange that it is using a permitted pricing model as defined in the rule for purposes of the Index Exemption. In addition, by such reliance, such member would authorize any other person carrying for such member an account including, or with whom such member has entered into, a position in a correlated instrument hedging the relevant option position to provide to the Exchange or OCC such information regarding such account or position as the Exchange or OCC may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under this exemption.²⁰

The index option positions of a non-member affiliate relying on the Index Exemption must be carried by a member with which it is affiliated. A member carrying an account that includes an index option position for a non-member affiliate that intends to rely on the Index Exemption would be required to obtain from such non-member affiliate a written certification that it is using a permitted pricing model as defined in the rule for purposes of the Index Exemption.²¹

¹⁸ See subparagraph (D) of proposed Rule 24.4.05.

¹⁹ See proposed Rule 24.4.05(D)(3).

²⁰ See subparagraph (E) of proposed Rule 24.4.05.

²¹ In addition, the member would be required to obtain from such non-member affiliate a written statement confirming that such non-member affiliate: (a) is relying on the Index Exemption; (b) will use only a permitted pricing model for purposes of calculating the net delta of its option positions for purposes of the Index Exemption; (c) will promptly notify the member if it ceases to rely on the Index Exemption; (d) authorizes the member to provide to the Exchange or the OCC such information regarding positions of the non-member affiliate as the Exchange or OCC may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under the Index Exemption; and (e) if the non-

A member carrying an account that includes an index option position for a customer that intends to rely on the Index Exemption would be required to obtain from such customer and provide to the Exchange a written certification that the customer is using the OCC Model as defined in the rule for purposes of the Index Exemption.²²

Reporting. Under proposed Rule 24.4.05(F), each member (other than an Exchange Market-Maker, DPM or LMM using the OCC Model) relying on the Index Exemption would be required to report, in accordance with Rule 4.13,²³ (i) all index option positions (including those that are delta neutral) that are reportable thereunder, and (ii) on its own behalf or on behalf of a designated aggregation unit pursuant to Rule 24.4.05(D), for each such account that holds an index option position subject to the Index Exemption in excess of the levels specified in Rule 24.4 (and Rule 24.4A, in the case of industry index options) the net delta and the options contract equivalent of the net delta of such position.

Records. Under proposed Rule 24.4.05(G), each member relying on the Index Exemption would be required to (i) retain, and would be required to undertake reasonable efforts to ensure that any non-member affiliate of the member or customer relying on the Index Exemption retains, a list of the options, securities and other instruments underlying each options position net delta calculation reported to the Exchange hereunder, and (ii) produce such information to the Exchange upon request.²⁴

member affiliate is using the OCC Model, has duly executed and delivered to the Exchange such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on the Exemption. See subparagraph (E)(3) of proposed Rule 24.4.05.

²² In addition, the member would be required to obtain from such customer a written statement confirming that such customer: (a) is relying on this exemption; (b) will use only the OCC Model for purposes of calculating the net delta of the customer's option positions for purposes of this exemption; (c) will promptly notify the member if the customer ceases to rely on this exemption; (d) in connection with using the OCC Model, has duly executed and delivered to the member such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on this exemption.

²³ Exchange Rule 4.13 requires, among other things, that members report to the Exchange aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of options contracts dealt in on the Exchange.

²⁴ A member would be authorized to report position information of its non-member affiliate pursuant to the written statement required under proposed Rule 24.4.05(E)(3)(ii)(d).

Reliance on Federal Oversight. As provided under proposed Rule 24.4.05(C), a permitted pricing model includes proprietary pricing models used by members and affiliates that have been approved by the SEC, the Fed or another federal financial regulator. In adopting the proposed Index Exemption the Exchange would be relying upon the rigorous approval processes and ongoing oversight of a federal financial regulator. The Exchange notes that it would not be under any obligation to verify whether a member's or its affiliate's use of a proprietary pricing model is appropriate or yielding accurate results.

The Exchange will announce the effective date of the proposed rule change in a regulatory circular to be published no later than 60 days after Commission approval. The effective date shall be no later than 30 days after publication of the regulatory circular.

* * * * *

(b) Statutory Basis

The Exchange believes that this proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934 ("Act")²⁵, in general, and furthers the objectives of Section 6(b)(5) of the Act²⁶ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, 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 Exchange believes that allowing correlated instruments to be included in the calculation of an equity option's net delta would enable eligible market participants to more fully realize the benefit of the delta based equity hedge exemption. The proposed delta-based index hedge exemption would be substantially similar to the delta-based equity hedge exemption under Rule 4.11.04. Also, the Commission has previously stated its

²⁵ 15 U.S.C. 78f(b).

²⁶ 15 U.S.C. 78f(b)(5).

support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.²⁷

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

This proposed rule change does not impose any burden on competition that is 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

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

Item 6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period specified in Section 19(b)(2) of the Act for Commission consideration of the proposed rule change.

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 the Commission

The proposed rule change is not based on the rules of another SRO or the Commission.

Item 9. Exhibits

- Exhibit 1. Form of Notice of Proposed Rule Change for publication in the Federal Register.
- Exhibit 2. Not applicable.
- Exhibit 3. Not applicable.
- Exhibit 4. Not applicable.
- Exhibit 5. Text of Proposed Rule Change.

²⁷ See Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59380 (November 3, 1998) (adopting rules relating to OTC Derivatives Dealers).

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. SR-CBOE-2010-021)

Dated: _____

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule Change Relating to Correlated Instrument Delta Hedge Exemption

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on _____, 2010, 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 (i) expand the delta hedging exemption available for equity options position limits, (ii) amend the reporting requirements applicable to members relying on the delta hedging exemption, and (iii) adopt a delta hedging exemption from certain index options position limits. The text of the rule proposal is available on the Exchange's website (<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

¹ 15 U.S.C. 78s(b)(1).
² 17 CFR 240.19b-4.

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

I. Expansion of Delta-Based Equity Hedge Exemption

On December 14, 2007,³ the Commission approved a proposed rule change establishing an exemption from equity options position and exercise limits for positions held by CBOE members, and certain of their affiliates, that are “delta neutral”⁴ under a “permitted pricing model”⁵, subject to certain conditions (“Exemption”).

The “options contract equivalent of the net delta” of a hedged equity option position is subject to the position limits under Rule 4.11, subject to the availability of other exemptions.⁶ Currently, the Exemption only is available for securities that directly underlie the applicable option position. This means that with respect to options on exchange-traded funds (“ETF options”), index options overlying the same index on which the ETF is based currently cannot be combined with the ETF options to calculate a net delta for purposes of the Exemption.

Many ETF options overlie exchange-traded funds that track the performance of an

³ See Securities Exchange Act Release No. 56970 (December 14, 2007), 72 FR 72428 (December 20, 2007). The exemption was extended to certain customers whose accounts are carried by a member. See Securities Exchange Act Release No. 60555 (August 21, 2009) 74 FR 43741 (August 27, 2009).

⁴ The term “delta neutral” is defined in 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.

⁵ Permitted pricing model is defined in Rule 4.11.04(c)(C).

⁶ The term “options contract equivalent of the net delta” is defined in Rule 4.11.04(c)(B) as the net delta divided by the number of shares underlying the option contract. The term “net delta” is defined in the same rule 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, as determined in accordance with a permitted pricing model.

index. For example, options on Standard & Poor's Depository Receipts ("SPY") track the performance of the S&P 500 index. Market participants often hedge SPY options with options on the S&P 500 Index ("SPX options") or with other financial instruments based on the S&P 500 Index for risk management purposes. The Exchange believes that in order for eligible market participants to more fully benefit from the Exemption as it relates to ETF options, securities and other instruments that are based on the same underlying ETF or the same index on which the ETF is based should also be included in any determination of an ETF option position's net delta or whether the options position is hedged delta neutral.⁷

Accordingly, the Exchange proposes to expand the Exemption by amending Rule 4.11.04(c)(A) to permit equity option positions for which the underlying security is an ETF that is based on the same index as an index option to be combined with an index option position for calculation of the delta-based equity hedge exemption. The proposed rule would allow financial products such as securities index options, index futures, and options on index futures to be included along with the ETF in an equity option's net delta calculation. So for example, the proposed rule would allow SPY options to be hedged not only with SPY shares, but with S&P 500 options, S&P 500 futures, options on S&P 500 futures or any other instrument that tracks the performance of or is based on the S&P 500 index. This would be accomplished by including such positions with a related index option position in accordance with the Delta-Based Index Hedge Exemption rule proposed below.

Index options and equity options (i.e., ETF options) that are eligible to be combined for computing a delta-based hedge exemption, along with all securities and/or other instruments that are based on or track the performance of the same underlying security or index, will be grouped and the net delta and options contract equivalent of the net delta will

⁷ However, this would not include baskets of securities for purposes of the Exemption.

be calculated for each respective option class based on offsets realized from the grouping as a whole.

The Exchange proposes to amend the definition of “net delta” in Rule 4.11.04(c)(B) to mean, at any time, the number of shares and/or other units of trade⁸ (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, as determined in accordance with a permitted pricing model. The Exchange proposes to amend the definition of the “option contract equivalent of the net delta” to mean the net delta divided by the number of shares that equate to one option contract on a delta basis.⁹

II. Reporting Requirement

Rule 4.11.04(c)(F) sets forth the reporting requirements applicable to CBOE members who rely on the Exemption. The Exchange proposes to amend Rule 4.11.04(c)(F) to exempt from the reporting requirements Exchange Market-Makers and Designated Primary Market-Makers (“DPMs”) relying on the Exemption who use the Options Clearing Corporation (“OCC”) pricing model, because Market-Maker and DPM position and delta information can be accessed through the Exchange's market surveillance systems. This proposed exemption is consistent with similar exemptions from the reporting requirements under Rule 4.13 and those applicable to broad-based index options and FLEX options.¹⁰

III. Delta-Based Index Hedge Exemption

⁸ “Other units of trade” would include, for example, options or futures contracts hedging the relevant option position. When determining whether an ETF option hedged with other instruments such as ETF or index options is delta neutral, the relative size of the ETF option when compared to the other product is taken into consideration. For example, SPX options are ten (10) times larger than SPY options thus 1 SPX delta is equivalent to .10 SPY deltas.

⁹ The Exchange also proposes to amend Rule 4.11.04(c)(C)(2) to clarify that there is no longer a consolidated supervision program by the SEC pursuant to Appendix E of Rule 15c3-1 of the Act.

¹⁰ See Rules 4.13(b), 24.4.03 and 24A.7(b) and (c).

Most index options traded on the Exchange are subject to position and exercise limits, as provided under CBOE Rules 24.4, 24.4A and 24.4B.¹¹ Certain broad-based index options are not subject to position and exercise limits.¹² Position limits are imposed, generally, to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the holder of the options position.

Index options are often used by market participants such as institutional investors to hedge large portfolios. Exchange rules include hedge exemptions to allow certain positions in index options in excess of the applicable standard position limit if hedged with an Exchange-approved qualified portfolio.¹³ Under Rule 24.4.01(c) (broad-based index hedge exemption), a qualified portfolio may consist of common stocks or securities readily convertible to common stock, and/or index futures contracts, options on index futures contracts, or long or short positions in index options or index warrants that meet certain standards. Under Rule 24.4A.01(a) (industry index hedge exemption), a qualified portfolio may consist only of underlying component stocks or in securities readily convertible to such component stocks. In the case of both hedge exemptions, the maximum size of the exempt position is set at a specified maximum number of contracts.

The Exchange believes that any limit on the ability of market participants to use index options to hedge their portfolios exposes market participants to unnecessary risk on the unhedged portion of their portfolios. The Exchange proposes to adopt a delta-based

¹¹ Rules 24.4, 24.4A and 24.4B provide position limits for broad-based index options, industry index options and micro narrow-based index options, respectively.

¹² Broad-based index options not subject to position and exercise limits are DJX, OEX, XEO, NDX, RUT, VIX, VXN, VXD and SPX. See CBOE Rules 24.4(a) and 24.5.

¹³ See Interpretation and Policy .01 to Rule 24.4 (broad-based index hedge exemption) and Interpretation and Policy .01 to Rule 24.4A (industry index hedge exemption).

exemption from index option position and exercise limits that is substantially similar to the delta-based equity hedge exemption under Rule 4.11.04(c). A delta-based index hedge exemption would provide market participants the ability to accumulate an unlimited number of index options contracts provided that such contracts are properly delta hedged in accordance with the requirements of the exemption.

Proposed Exemption. The Exchange proposes to adopt an exemption from index options position and exercise limits¹⁴ for positions held by CBOE members and certain of their affiliates, and customers that are "delta neutral" (as defined below) under a "permitted pricing model" (as defined below), subject to certain conditions ("Index Exemption"). The Index Exemption under proposed Rule 24.4.05 would also apply to industry index options under proposed Rule 24.4A.03.

The term "delta neutral" is defined in proposed Rule 24.4.05(A) as referring to an index option position that is hedged, in accordance with a permitted pricing model, by a position in one or more correlated instruments for the purpose of offsetting the risk that the value of the option position will change with incremental changes in the value of the underlying index. Correlated instruments would be defined to mean securities and/or other instruments that track the performance of or are based on the same underlying index as the index underlying the option position. These definitions would allow financial products such as ETF options, index futures, options on index futures and ETFs that track the performance of or are based on the same underlying index to be included in an index option's net delta calculation.¹⁵

Any index option position that is not delta neutral would be subject to position and

¹⁴ Exchange Rule 24.5 establishes exercise limits for an index option at the same level as the index option's position limit under index options position limit rules, therefore no changes are proposed to Rule 24.5.

¹⁵ See Supra footnote 5.

exercise limits, subject to the availability of other exemptions. Only the "options contract equivalent of the net delta" of such position would be subject to the appropriate position limit.¹⁶

In addition, members could not use the same positions in correlated instruments in connection with more than one hedge exemption. Therefore, a position in correlated instruments used as part of a delta hedging strategy could not also serve as the basis for any other index hedge exemption.

Permitted Pricing Model. Under the proposed rule, the calculation of the delta for any index option position, and the determination of whether a particular index option position is hedged delta neutral, must be made using a permitted pricing model. A "permitted pricing model" is defined in proposed Rule 24.4.05(C) to have the same meaning as defined in Rule 4.11.04(c)(C), namely, the pricing model maintained and operated by OCC and the pricing models used by (i) a member or its affiliate subject to consolidated supervision by the SEC or pursuant to Appendix E of SEC Rule 15c3-1; (ii) 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;¹⁷ (iii) an SEC registered OTC

¹⁶ Under proposed Rule 24.4.05(B), the term "options contract equivalent of the net delta" is defined as the net delta divided by units of trade that equate to one option contract on a delta basis, and the term "net delta" is defined as, at any time, the number of shares and/or other units of trade (either long or short) required to offset the risk that the value of an index option position will change with incremental changes in the value of the underlying index, as determined in accordance with a permitted pricing model.

¹⁷ The pricing model of an FHC or of an affiliate of an FHC would have to be consistent with: (i) the requirements of the Board of Governors of the Federal Reserve System ("Fed"), as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Fed, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such company's consolidated supervised holding company group; or (ii) the standards published by the Basel Committee on Banking Supervision, as amended from time to time and as implemented by such company's principal regulator, in connection with the calculation of risk-based deductions or adjustments to or allowances for the market risk capital requirements of such principal regulator applicable to such company – where "principal regulator" means a member of the Basel Committee on Banking Supervision that is the home country consolidated supervisor of such company – provided that the member or affiliate of a member relying on this exemption in connection with the use of such

derivatives dealer;¹⁸ and (iv) a national bank.¹⁹ Customers seeking to use the delta-based index hedge exemption could only hedge their position in accordance with the OCC model.

Aggregation of Accounts. Members, non-member affiliates and customers relying on the Index Exemption would be required to ensure that the permitted pricing model is applied to all positions in correlated instruments hedging the relevant option position that are owned or controlled by the member, or its affiliates.

However, the net delta of an index option position held by an entity entitled to rely on the Index Exemption, or by a separate and distinct trading unit of such entity, may be calculated without regard to positions in correlated instruments held by an affiliated entity or by another trading unit within the same entity, provided that: (i) the entity demonstrates to the Exchange's satisfaction that no control relationship, as defined in Rule 4.11.03, exists between such affiliates or trading units, and (ii) the entity has provided the Exchange written notice in advance that it intends to be considered separate and distinct from any affiliate, or, as applicable, which trading units within the entity are to be considered separate and distinct from each other for purposes of the Index Exemption.²⁰ The Exchange has set forth in Regulatory Circular RG08-12 the conditions under which it will deem no control relationship to exist between affiliated broker-dealers and between separate and distinct trading units

model is an entity that is part of such company's consolidated supervised holding company group. See subparagraph (C) of proposed Rule 24.4.05, which incorporates Rule 4.11.04(c)(C).

¹⁸ The pricing model of an SEC registered OTC derivatives dealer would have to be consistent with the requirements of Appendix F to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital for market risk thereunder. Only an OTC derivatives dealer and no other affiliated entity (including a member) would be able to rely on this part of the Exemption. See subparagraph (C) of proposed Rule 24.4.05, which incorporates Rule 4.11.04(c)(C).

¹⁹ The pricing model of a national bank would have to be consistent with the requirements of the Office of the Comptroller of the Currency, as amended from time to time, in connection with the calculation of risk-based adjustments to capital for market risk under capital requirements of the Office of the Comptroller of the Currency. Only a national bank and no other affiliated entity (including a member) would be able to rely on this part of the Exemption. See subparagraph (C) of proposed Rule 24.4.05, which incorporates Rule 4.11.04(c)(C).

²⁰ See subparagraph (D) of proposed Rule 24.4.05.

within the same broker-dealer.

Any member, non-member affiliate or customer relying on the Index Exemption must designate, by prior written notice to the Exchange, each trading unit or entity whose options positions are required by Exchange rules to be aggregated with the options positions of such member, non-member affiliate or customer relying on the Index Exemption for purposes of compliance with Exchange position or exercise limits.²¹

Obligations of Members and Affiliates. Any member relying on the Index Exemption would be required to provide a written certification to the Exchange that it is using a permitted pricing model as defined in the rule for purposes of the Index Exemption. In addition, by such reliance, such member would authorize any other person carrying for such member an account including, or with whom such member has entered into, a position in a correlated instrument hedging the relevant option position to provide to the Exchange or OCC such information regarding such account or position as the Exchange or OCC may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under this exemption.²²

The index option positions of a non-member affiliate relying on the Index Exemption must be carried by a member with which it is affiliated. A member carrying an account that includes an index option position for a non-member affiliate that intends to rely on the Index Exemption would be required to obtain from such non-member affiliate a written certification that it is using a permitted pricing model as defined in the rule for purposes of the Index Exemption.²³

²¹ See proposed Rule 24.4.05(D)(3).

²² See subparagraph (E) of proposed Rule 24.4.05.

²³ In addition, the member would be required to obtain from such non-member affiliate a written statement confirming that such non-member affiliate: (a) is relying on the Index Exemption; (b) will use only a permitted

A member carrying an account that includes an index option position for a customer that intends to rely on the Index Exemption would be required to obtain from such customer and provide to the Exchange a written certification that the customer is using the OCC Model as defined in the rule for purposes of the Index Exemption.²⁴

Reporting. Under proposed Rule 24.4.05(F), each member (other than an Exchange Market-Maker, DPM or LMM using the OCC Model) relying on the Index Exemption would be required to report, in accordance with Rule 4.13,²⁵ (i) all index option positions (including those that are delta neutral) that are reportable thereunder, and (ii) on its own behalf or on behalf of a designated aggregation unit pursuant to Rule 24.4.05(D), for each such account that holds an index option position subject to the Index Exemption in excess of the levels specified in Rule 24.4 (and Rule 24.4A, in the case of industry index options) the net delta and the options contract equivalent of the net delta of such position.

Records. Under proposed Rule 24.4.05(G), each member relying on the Index Exemption would be required to (i) retain, and would be required to undertake reasonable efforts to ensure that any non-member affiliate of the member or customer relying on the Index Exemption retains, a list of the options, securities and other instruments underlying

pricing model for purposes of calculating the net delta of its option positions for purposes of the Index Exemption; (c) will promptly notify the member if it ceases to rely on the Index Exemption; (d) authorizes the member to provide to the Exchange or the OCC such information regarding positions of the non-member affiliate as the Exchange or OCC may request as part of the Exchange's confirmation or verification of the accuracy of any net delta calculation under the Index Exemption; and (e) if the non-member affiliate is using the OCC Model, has duly executed and delivered to the Exchange such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on the Exemption. See subparagraph (E)(3) of proposed Rule 24.4.05.

²⁴ In addition, the member would be required to obtain from such customer a written statement confirming that such customer: (a) is relying on this exemption; (b) will use only the OCC Model for purposes of calculating the net delta of the customer's option positions for purposes of this exemption; (c) will promptly notify the member if the customer ceases to rely on this exemption; (d) in connection with using the OCC Model, has duly executed and delivered to the member such documents as the Exchange may require to be executed and delivered to the Exchange as a condition to reliance on this exemption.

²⁵ Exchange Rule 4.13 requires, among other things, that members report to the Exchange aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of options contracts dealt in on the Exchange.

each options position net delta calculation reported to the Exchange hereunder, and (ii) produce such information to the Exchange upon request.²⁶

Reliance on Federal Oversight. As provided under proposed Rule 24.4.05(C), a permitted pricing model includes proprietary pricing models used by members and affiliates that have been approved by the SEC, the Fed or another federal financial regulator. In adopting the proposed Index Exemption the Exchange would be relying upon the rigorous approval processes and ongoing oversight of a federal financial regulator. The Exchange notes that it would not be under any obligation to verify whether a member's or its affiliate's use of a proprietary pricing model is appropriate or yielding accurate results.

The Exchange will announce the effective date of the proposed rule change in a regulatory circular to be published no later than 60 days after Commission approval. The effective date shall be no later than 30 days after publication of the regulatory circular.

. 2. Statutory Basis

The Exchange believes that this proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934 ("Act")²⁷, in general, and furthers the objectives of Section 6(b)(5) of the Act²⁸ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, 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 Exchange believes that allowing correlated instruments to be included in the calculation of an equity option's net

²⁶ A member would be authorized to report position information of its non-member affiliate pursuant to the written statement required under proposed Rule 24.4.05(E)(3)(ii)(d).

²⁷ 15 U.S.C. 78f(b).

²⁸ 15 U.S.C. 78f(b)(5).

delta would enable eligible market participants to more fully realize the benefit of the delta based equity hedge exemption. The proposed delta-based index hedge exemption would be substantially similar to the delta-based equity hedge exemption under Rule 4.11.04. Also, the Commission has previously stated its support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.²⁹

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

The Exchange neither solicited nor received comments on the proposal.

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

(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

²⁹ See Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59380 (November 3, 1998) (adopting rules relating to OTC Derivatives Dealers).

Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>);
or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2010-021 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-2010-021. 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-2010-021 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.³⁰

Dated: _____

Florence E. Harmon
Deputy Secretary

³⁰ 17 CFR 200.30-3(a)(12).

EXHIBIT 5 TO SR-CBOE-2010-021

(Underlining indicates material to be added and brackets [] indicate material to be deleted.)

**Chicago Board Options Exchange, Incorporated
Rules**

CHAPTER IV

BUSINESS CONDUCT

Rule 4.11 - Position Limits

Rule 4.11. Except with the prior permission of the President or his designee, to be confirmed in writing, no member shall make, for any account in which it has an interest or for the account of any customer, an opening transaction on any exchange if the member has reason to believe that as a result of such transaction the member or its customer would, acting alone or in concert with others, directly or indirectly, (a) control an aggregate position in an option contract dealt in on the Exchange in excess of 25,000 or 50,000 or 75,000 or 200,000 or 250,000 option contracts (whether long or short), of the put type and the call type on the same side of the market respecting the same underlying security, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options, or such other number of option contracts as may be fixed from time to time by the Exchange as the position limit for one or more classes or series of options, or (b) exceed the applicable position limit fixed from time to time by another exchange for an option contract not dealt in on the Exchange, when the member is not a member of the other exchange on which the transaction was effected. In addition, should a member have reason to believe that a position in any account in which it has an interest or for the account of any customer is in excess of the applicable limit, such member shall promptly take the action necessary to bring the position into compliance. Reasonable notice shall be given of each new position limit fixed by the Exchange, by publicly posting notice thereof. Limits shall be determined in the manner described in Interpretations .02 and .04 below.

... Interpretations and Policies:

.01 - .03 *No change.*

.04 Equity Hedge Exemptions

(a) – (b) *No change.*

(c) Delta-Based Equity Hedge Exemption

The Delta-Based Equity Hedge Exemption is in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. An equity option position of a member, non-member affiliate of a member or customer that is delta neutral shall be exempt from established position limits as prescribed under Interpretation .02 above, subject to the following:

(A) The term “delta neutral” refers 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. Customers seeking to use the delta-based equity hedge exemption may only hedge their positions in accordance with a pricing model maintained and operated by the Clearing Corporation ("OCC Model").

In the case of an equity option position for which the underlying security is an ETF that is based on the same index as an index option, the equity option position and any position in the underlying ETF may be combined with such an index option position and/or correlated instruments, as defined in Rule 24.4.05(A), in accordance with Rule 24.4.05 – Delta-Based Index Hedge Exemption, for calculation of the delta-based equity hedge exemption.

(B) An equity option position that is not delta neutral shall be subject to position limits in accordance with this Rule 4.11 (subject to the availability of other position limit exemptions). Only the option contract equivalent of the net delta of such position shall be subject to the appropriate position limit. The "options contract equivalent of the net delta" is the net delta divided by the number of shares [underlying the option contract] that equate to one option contract on a delta basis. The term "net delta" means, at any time, the number of shares and/or other units of trade (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, as determined in accordance with a permitted pricing model.

(C) A "permitted pricing model" means -

(1) OCC Model;

(2) A pricing model maintained and used by a member subject to consolidated supervision by the Commission or pursuant to Appendix E of Commission Rule 15c3-1, or by an affiliate that is part of such member's consolidated supervised holding company group, in accordance with its internal risk management control system and consistent with the requirements of Appendices E or G, as applicable, to SEC Rule 15c3-1 and SEC Rule 15c3-4 under the Act, as amended from time to time, in connection with the calculation of risk-based deductions from capital or capital allowances for market risk thereunder, provided that the member or affiliate of a member relying on this exemption in connection with the use of such model is an entity that is part of such member's consolidated supervised holding company group;

(3) – (5) *No change.*

(D) *No change*

(E) *No change.*

(F) Reporting.

Each member (other than an Exchange market-maker or DPM using the OCC Model) that holds or carries an account that relies on this exemption shall report, in accordance with Rule 4.13, all equity option positions (including those that are delta neutral) that are reportable thereunder. Each such member on its own behalf or on behalf of a designated aggregation unit pursuant to Rule 4.11.04(c)(D) shall also report, in accordance with Rule 4.13, for each such account that holds an equity option position subject to this

exemption in excess of the levels specified in this Rule 4.11, the net delta and the options contract equivalent of the net delta of such position.

(G) Records. *No change.*

.05 - .07 *No change.*

EXHIBIT 5 TO SR-CBOE-2010-021 (continued)

(Underlining indicates material to be added and brackets [] indicate material to be deleted.)

CHAPTER XXIV

Index Options

Rule 24.4 – Position Limits for Broad-Based Index Options

(a) – (e) No Change.

... Interpretations and Policies:

.01 - .04 No Change.

.05 Delta-Based Index Hedge Exemption

The Delta-Based Index Hedge Exemption is in addition to the standard limit and other exemptions available under Exchange rules, interpretations and policies. An index option position of a member, non-member affiliate of a member or customer that is delta neutral shall be exempt from established position limits as prescribed under this Rule 24.4, subject to the following:

- (A) The term “delta neutral” refers to an index option position that is hedged, in accordance with a permitted pricing model, by a position in one or more correlated instruments, for the purpose of offsetting the risk that the value of the option position will change with incremental changes in the value of the underlying index. The term “correlated instruments” means securities and/or other instruments that track the performance of or are based on the same underlying index as the index underlying the option position (but not including baskets of securities). Customers seeking to use the delta-based index hedge exemption may only hedge their positions in accordance with the OCC Model as defined in Rule 4.11.04(c)(C).
- (B) An index option position that is not delta neutral shall be subject to position limits in accordance with this Rule 24.4 (subject to the availability of other position limit exemptions). Only the options contract equivalent of the net delta of such position shall be subject to the appropriate position limit. The “options contract equivalent of the net delta” is the net delta divided by units of trade that equate to one option contract on a delta basis. The term “net delta” means, at any time, the number of shares and/or other units of trade (either long or short) required to offset the risk that the value of an index option position will change with incremental changes in the value of the underlying index, as determined in accordance with a permitted pricing model.
- (C) A “permitted pricing model” shall have the meaning as defined in Rule 4.11.04(c)(C).
- (D) Effect on Aggregation of Accounts
 - (1) Members, non-member affiliates and customers who rely on this exemption must ensure that the permitted pricing model is applied to all positions in correlated

