

OMB APPROVAL

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

File No.* SR - 2012 - * 043

Amendment No. (req. for Amendments *)

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

Initial * Amendment * Withdrawal Section 19(b)(2) * Section 19(b)(3)(A) * Section 19(b)(3)(B) *

Rule

Pilot Extension of Time Period for Commission Action * Date Expires *

19b-4(f)(1) 19b-4(f)(4)
 19b-4(f)(2) 19b-4(f)(5)
 19b-4(f)(3) 19b-4(f)(6)

Exhibit 2 Sent As Paper Document

Exhibit 3 Sent As Paper Document

Description

Provide a brief description of the proposed rule change (limit 250 characters, required when Initial is checked *).

This filing proposes to adopt universal spread margin rules.

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 * Angelo Last Name * Evangelou

Title * Associate General Counsel

E-mail * evangelou@cboe.com

Telephone * (312) 786-7464 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 05/11/2012

By Angelo Evangelou
 (Name *)

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.

Angelo Evangelou evangelou@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 (required)

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

Exhibit 1 - Notice of Proposed Rule Change (required)

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

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

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Exhibit Sent As Paper Document

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

Exhibit 3 - Form, Report, or Questionnaire

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

Exhibit 4 - Marked Copies

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

Exhibit 5 - Proposed Rule Text

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

Partial Amendment

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

Item 1. Text of the Proposed Rule Change

(a) Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) proposes to amend the provisions of Rule 12.3, Margin Requirements, that pertain to option spread margin requirements to implement a universal methodology for determining a spread margin requirement that would accommodate the many types of spread strategies in use today, and which will enable a wider variety of multi-leg option spreads, including numerous variations of butterfly and condor spreads, to be accommodated. The text of the proposed rule change is provided below (additions are underlined; deletions are [bracketed]).

(b) Not applicable.

(c) Not applicable.

Chicago Board Options Exchange, Incorporated

Rules

* * * * *

Rule 12.3 - Margin Requirements

(a) *Definitions.* For purposes of this Rule, the following terms shall have the meanings specified below.

(1) – (4) No change

(5) For the purpose of this rule, the term “spread” means an equivalent long and short position in different call option series, different put option series, or combinations thereof, that collectively have a limited risk / reward profile, and meet the following conditions 1) all options must have the same underlying security or instrument, 2) all options must be either all American style or all European style, 3) all options must be either all listed or all OTC, 4) within option type(s), the long and short options must have equal aggregate underlying contract values and 5) the short option(s) must expire on or before the expiration date of the long option(s)[The term "long butterfly spread" means **long put / two short puts / long put or long call / two short calls / long call** where: the options are on the same underlying instrument, the long options are different

option series, the short options are the same option series, the exercise prices of the positions are in ascending order, either all options expire at the same time or a long option expires after the other options expire concurrently, and the interval between exercise prices is equal. In the case of long butterfly spreads composed of cash-settled, European-style index options, all options must expire at the same time.

(6) The term "short butterfly spread" means **short put / two long puts / short put** or **short call / two long calls / short call** where: the options are on the same underlying instrument, the short options are different option series, the long options are the same option series, the exercise prices of the positions are in ascending order, all options expire at the same time, and the interval between exercise prices is equal.

(7) The term "long condor spread" means **long put / short put / short put / long put** or **long call / short call / short call / long call** where: the options are on the same underlying instrument, each option is a different option series, the exercise prices of the options are in ascending order, either all options expire at the same time or a long option expires after the other options expire concurrently, and the interval between exercise prices is equal. In the case of long condor spreads composed of cash-settled, European-style index options, all options must expire at the same time.

(8) The term "short iron butterfly spread" means **long put / short put / short call / long call** where: the options are on the same underlying instrument, each option is a different option series, the exercise prices of the options are in ascending order, the short options have the same exercise price, either all options expire at the same time or a long option expires after the other options expire concurrently, and the interval between exercise prices is equal. In the case of short iron butterfly spreads composed of cash-settled, European-style index options, all options must expire at the same time.

(9) The term "short iron condor spread" means **long put / short put / short call / long call** where: the options are on the same underlying instrument, each option is a different option series, the exercise prices of the options are in ascending order, either all options expire at the same time or a long option expires after the other options expire concurrently, and the interval between exercise prices is equal. In the case of short iron condor spreads composed of cash-settled, European-style index options, all options must expire at the same time.]

([10]6) The term "box spread" means an aggregation of positions in a long call option and short put option with the same exercise price ("buy side") coupled with a long put option and short call option with the same exercise price ("sell side") all of which have the same underlying component or index and time of expiration, and are based on the same aggregate current underlying value, and are structured as either: A) a "long box spread" in which the sell side exercise price exceeds the buy side exercise price or B) a "short box spread" in which the buy side exercise price exceeds the sell side exercise price.

([11]7) The term "underlying stock basket" means a group of securities which includes each of the component securities of the applicable index and which meets the following conditions (i) the quantity of each stock in the basket is proportional to its representation in the index, (ii) the total market value of the basket is equal to the underlying index value of the index options or warrants to be covered, (iii) the securities in the basket cannot be used to cover more than the number of index options or warrants represented by that value and (iv) the securities in the basket shall be unavailable to support any other option or warrant transaction in the account.

([12]8) The term "cash equivalent" is as defined in Section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System.

([13]9) The term "listed" for purposes of this Chapter 12 means a security traded on a registered national securities exchange or automated facility of a registered national securities association.

([14]10) The term "OTC margin bond" for purposes of this Chapter 12 means (1) any debt securities not traded on a national securities exchange that meet all of the following requirements (a) at the time of the original issue, a principal amount of not less than \$25,000,000 of the issue was outstanding; (b) the issue was registered under Section 5 of the Securities Act of 1933 and the issuer either files periodic reports pursuant to the Act or is an insurance company under Section 12(g)(2)(G) of the Act; or (c) at the time of the extension of credit the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments; or (2) any private pass-through securities (not guaranteed by a U.S. government agency) that meet all of the following requirements: (a) an aggregate principal amount of not less than \$25,000,000 was issued pursuant to a registration statement filed with the Commission; and (b) current reports relating to the issue have been filed with the Commission; and (c) at the time of the credit extension, the creditor has a reasonable basis for believing that mortgage interest, principal payments and other distributions are being passed through as required and that the servicing agent is meeting its material obligations under the terms of the offering.

([15]11) The term "Investment Grade" in respect of any Corporate Debt Security, as that term is defined in Rule 28.1, means, if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated in one of the four highest generic rating categories; or if rated by more than one NRSRO, is rated in one of the four highest generic rating categories by all or a majority of such NRSROs; provided that if the NRSROs assign ratings that are evenly divided between (i) the four highest generic ratings and (ii) ratings lower than the four highest generic ratings, the Exchange will classify the Corporate Debt Security as Non-Investment Grade.

([16]12) The term "Non-Investment Grade" in respect of any Corporate Debt Security, as that term is defined in Rule 28.1, means, if rated by only one NRSRO (as defined in Rule 12.3(a)(15)), is rated lower than one of the four highest generic rating categories;

or if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by all or a majority of such NRSROs.

~~(17)~~13 The term "Convertible" in respect of any Corporate Debt Security, as that term is defined in Rule 28.1, means, notwithstanding the classification of a Corporate Debt Security as Investment Grade or Non-Investment Grade, means any Corporate Debt Security that may be exchanged for shares of the issuer's common or preferred stock.

(14) The term "OTC" as used with reference to a call or put option contract means an over-the-counter option contract that is not traded on a national securities exchange and is issued and guaranteed by the carrying broker-dealer.

(b) Customer Margin Accounts – General Rule. No change

(c) Customer Margin Account – Exception.

(1) – (5) (C) (3) No change

(4) Spreads. [Long Position Does Not Expire Before Short Position. This subparagraph applies to accounts carrying positions where long call options or call warrants (or long put options or put warrants), except for capped style options, offset positions in short call options or call warrants (or short put options or put warrants) for the same underlying component or index, provided the offsetting long position does not expire before the short position and the long position is paid in full. A long warrant may offset a short option contract and a long option contract may offset a short warrant provided they have the same underlying component or index and equivalent aggregate current underlying value. In the event the long position is not listed, it must be guaranteed by the carrying broker dealer; otherwise the short position must be margined separately pursuant to subparagraph (c)(5)(A) or (B), whichever is applicable.]

(A) For spreads as defined in subparagraph (a)(5) of this Rule, the long options must be paid for in full. In addition, margin is required equal to the lesser of the amount required for the short option(s) by subparagraph (c)(5)(A) or (B), whichever is applicable, or the spread's maximum potential loss, if any. To determine the spread's maximum potential loss, first compute the intrinsic value of the options at price points for the underlying security or instrument that are set to correspond to every exercise price present in the spread. Then, net the intrinsic values at each price point. The maximum potential loss is the greatest loss, if any, from among the results. The proceeds for establishing the short options may be applied toward the cost of the long options and/or any margin requirement.

A spread involving a put(call) warrant combined with a put(call) option is permitted provided the spread conforms with the definition of a spread in subparagraph (a)(5) of this rule.[When the exercise price of the long call position

(or short put position) is less than or equal to the exercise price of the offsetting short call position (or long put position), no margin is required.]

(B) Subparagraph (4)(A) above is not applicable to spreads involving Credit Options, Binary Options or Range Options. However, in respect of spreads involving Range Options, subparagraph (4)(A) above may be applied to pseudo positions in individual option series represented by each Range Option to derive a margin requirement provided that all Range Options expire at the same time, which margin requirement is subject to a maximum of the amount required by paragraph (n) of this Rule 12.3 for all Range Options.[When the exercise price of the long call position (or short put position) is greater than the exercise price of the offsetting short call position (or long put position) the amount of margin required is the lesser of (1) the margin required pursuant to subparagraph (c)(5)(A) or B above whichever is applicable or (2) the difference in aggregate exercise prices.]

(C) Capped-Style Index Option (CAPS & Q-CAPS), Packaged Vertical Spread and Packaged Butterfly Spread As Defined In Rule 24.1.

- (1) The requirements set forth in subparagraph[s] (4)(A) [and (4)(B)] above apply to spreads composed of either CAPS, Q-CAPS, Packaged Vertical Spread or Packaged Butterfly Spread options provided the long and short option each have the same cap, vertical spread or butterfly spread interval (as applicable); except that[, in respect of spreads subject to subparagraph (4)(B),] the amount of margin required for a spread in CAPS, Q-CAPS or Packaged Vertical Spread options need not exceed the lesser of 1) any maximum potential loss as computed in accordance with subparagraph 4(A) above[difference in aggregate exercise prices] or 2) the cap, vertical spread or butterfly spread interval (as applicable). Cap interval, vertical spread interval and butterfly spread interval shall have the meanings defined in Rule 24.1.
- (2) In respect of a short CAPS, Q-CAPS or Packaged Vertical Spread option offset by a long option that is not also a CAPS, Q-CAPS or Packaged Vertical Spread option, the amount of margin required is as set forth in subparagraph (4)(A) [or (4)(B)] above; except that[, in respect of spreads subject to subparagraph (4)(B),] the amount of margin required need not exceed the lesser of 1) any maximum potential loss as computed in accordance with subparagraph (4)(A) above[the difference in aggregate exercise prices] or 2) the cap, vertical spread or butterfly spread interval (as applicable).
- (3) In respect of a long CAPS, Q-CAPS or Packaged Vertical Spread option which offsets a short option that is not also a CAPS, Q-CAPS or Packaged Vertical Spread option, each position must be margined separately in accordance with the applicable requirements of this Rule 12.3.

(4) In respect of any Packaged Butterfly Spread Option offset by, or which offsets, any option position that is not also a Packaged Butterfly Spread option, each position must be margined separately in accordance with the applicable requirements of this Rule 12.3.

(5) No change

[(6) *Long Butterfly Spread or Long Condor Spread.* This subparagraph (c)(5)(C)(6) applies to a long butterfly or condor spread as defined in subparagraphs (a)(5) and (a)(7), respectively, of this Rule where all option positions are listed or guaranteed by the carrying broker-dealer. In respect of a long butterfly or long condor spread as defined in subparagraphs (a)(5) and (a)(7), respectively, of this Rule, the net debit must be paid in full.

(7) *Short Butterfly Spread, Short Iron Butterfly Spread or Short Iron Condor Spread.* This subparagraph (c)(5)(C)(7) applies to a short butterfly, short iron butterfly or short iron condor spread as defined in subparagraphs (a)(6), (a)(8) and (a)(9), respectively, of this Rule where all option positions are listed or guaranteed by the carrying broker-dealer. In respect of a short butterfly, short iron butterfly or short iron condor spread as defined in subparagraphs (a)(6), (a)(8) and (a)(9), respectively, of this Rule, margin must be deposited and maintained equal to at least the amount of the exercise price interval. The net proceeds from the sale of short option components may be applied to the requirement.

(8) *Box Spread.* This subparagraph (c)(5)(C)(8) applies to box spreads as defined in subparagraph (a)(10) of this Rule where all option positions are listed or guaranteed by the carrying broker-dealer.

(1) In respect of a long box spread as defined in subparagraph (a)(10) of this Rule, the net debit must be paid in full.

(2) In respect of a short box spread as defined in subparagraph (a)(10) of this Rule, margin must be deposited and maintained equal to at least the amount of the aggregate difference between the exercise prices. The net proceeds from the sale of short option components may be applied to the requirement.]

[(9) *Long Box Spread in European-Style Options.* In respect of a long box spread as defined in subparagraph (a)(10) of this Rule, in which all component options have a European-style exercise provision and are listed or guaranteed by the carrying broker-dealer; margin must be deposited equal to at least 50% of the aggregate difference in the exercise prices. The net proceeds from the sale of short option components may be applied to the requirement. For margin purposes, the long box spread may be valued at an amount not to exceed 100% of the aggregate difference in the exercise prices.

([10]7) *Vested Employee Options*. No margin is required for a call option written on an equity security when an account holder possesses a "long" position in a vested employee stock option which can be immediately exercised without restriction (not including the payment of money) to purchase an equal or greater quantity of the security underlying the short call provided that:

(A) – (C) No change

(d) No change

(e) *Customer Cash Account—Spreads*. A spread as defined in subparagraph (a)(5) of this Rule, if composed of European-style cash-settled index options[, stock index warrant or currency index warrant] that expire at the same time, [carried in a short position]is deemed a covered position, and eligible for the cash account, provided [a]the long option component(s)[position in a European-style cash-settled index option, stock index warrant or currency warrant having the same underlying component or index that is based on the same aggregate current underlying value,] is(are) held in or purchased for the account on the same day as the short component(s) and provided:

(1) either there is held in the account at the time the positions are established or received into the account promptly:

(A) cash or cash equivalents of not less than the amount required by subparagraph (c)(5)(C)(4)(A), to which requirement the net proceeds from the sale of the short position(s) may be applied or[the long position and the short position expire concurrently,]

(B) an escrow agreement.[the long position is paid in full and

(C) either there is held in the account at the time the positions are established or received into the account promptly thereafter:

(1) cash or cash equivalents of not less than any amount by which the aggregate exercise price of the long call or call warrant (short put or put warrant) exceeds the aggregate exercise price of the short call or call warrant (long put or put warrant), to which requirement the net proceeds from the sale of the short position may be applied, or

(2) an escrow agreement.]

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement 1) cash, 2) cash equivalents or 3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount required by subparagraph (c)(5)(C)(4)(A) of this Rule[any amount by which the aggregate exercise price of a long call or call warrant (short put or put warrant) exceeds the aggregate

exercise price of a short call or call warrant (long put or put warrant)] and that the bank will promptly pay the TPH organization such amount in the event the account is assigned an exercise notice or that the bank will promptly pay the TPH organization funds sufficient to purchase a warrant sold short in the event of a buy-in.

(D) The provisions of this subparagraph (e)(1) are also applicable to put and call warrants. A long warrant and[may offset] a short option contract or[and] a long option contract and[may offset] a short warrant are eligible for the provisions of this subparagraph (e)(1) if they qualify as spreads as defined in subparagraph (a)(5) of this Rule[provided they have the same underlying component or index and equivalent aggregate current underlying value. In the event the long position is not listed, it must be guaranteed by the carrying broker dealer; otherwise the short position is not eligible for the cash account and must be margined separately pursuant to subparagraph (c)(5)(A) or (B), whichever is applicable.]

[(2) *Long Butterfly Spreads, Short Butterfly Spreads, Long Condor Spreads, Short Iron Butterfly Spreads or Short Iron Condor Spreads.* The captioned spreads, as defined in subparagraphs (a)(5), (a)(6), (a)(7), (a)(8) and (a)(9), respectively, of this Rule, are permitted in a cash account only if they are composed of cash-settled, European-style options and all options expire at the same time, and provided:

(A) the long options are held in, or purchased for the account on the same day,

(B) in respect of a long butterfly spread as defined in subparagraph (a)(5) and (a)(7), respectively, of this Rule, the net debit is paid in full,

(C) in respect of a short butterfly spread as defined in subparagraph (a)(6), (a)(8) and (a)(9), respectively, of this Rule, either there is held in the account at the time the positions are established or received into the account promptly thereafter:

(1) cash or cash equivalents of not less than the amount of the exercise price interval, to which requirement the net proceeds from the sale of short option components may be applied, or

(2) an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement 1) cash, 2) cash equivalents or 3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the exercise price interval and that the bank will promptly pay the TPH organization such amount in the event the account is assigned an exercise notice.

(D) all component options are listed or guaranteed by the carrying broker-dealer.

(3) *Box Spreads*. Put and call options carried in a short position are deemed covered positions and eligible for the cash account provided the account contains long positions which in conjunction with the short options constitute a box spread as defined in subparagraph (a)(6) of this Rule provided:

- (A) all component options are European style,
- (B) all component options are cash settled,
- (C) the long options are held in, or purchased for the account on the same day,
- (D) in respect of a long box spread as defined in subparagraph (a)(6) of this Rule, the net debit is paid in full,
- (E) in respect of a short box spread as defined in subparagraph (a)(6) of this Rule, either there is held in the account at the time the positions are established or received into the account promptly thereafter:
 - (1) cash or cash equivalents of not less than the amount of the aggregate difference between the exercise prices, to which requirement the net proceeds from the sale of short option components may be applied, or
 - (2) an escrow agreement.

The escrow agreement must certify that the bank holds for the account of the customer as security for the agreement 1) cash, 2) cash equivalents or 3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the exercise prices and that the bank will promptly pay the TPH organization such amount in the event the account is assigned an exercise notice on either short option.

(F) all component options are listed or guaranteed by the carrying broker-dealer.]

(f) – (n) No change

... *Interpretations and Policies*: 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 May 10, 2012. 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 Angelo Evangelou, (312) 786-7464.

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

(a) Purpose

An option spread is typically characterized by the simultaneous holding of a long and short option of the same type (put or call) where both options overly the same security or instrument, but have different exercise prices and/or expirations. To be eligible for spread margin treatment, the long option may not expire before the short option. These long put/short put or long call/short call spreads are known as two-legged spreads.

Since the inception of the Exchange, the margin requirements for two-legged spreads have been specified in CBOE margin rules.¹ The margin requirement for a two-legged spread that is eligible for spread margin treatment is its maximum risk based on the intrinsic values of the options, exclusive of any net option premiums paid or received when the positions were established.² For example, consider the following equity option spread:

Long 1 XYZ May2011 60 call
Short 1 XYZ May2011 50 call

¹ Chapter 12. Rule 12.3(c)(5)(C)(4).

² Any net credit received for establishing a spread may be applied to the margin requirement, if any. In the case of a spread that is established for a net debit, the net debit must be paid for in full.

The maximum potential loss (i.e., risk) for this particular spread would be a scenario where the price of the underlying stock (XYZ) is \$60 or higher. If the market price of XYZ is \$60, the May2011 60 call would have an intrinsic value of zero, because the right to buy at \$60 when XYZ can be purchased in the market for \$60 has no intrinsic value. The May2011 50 call would have an intrinsic value of \$10 because of the \$10 advantage gained by being able to buy at \$50 when it costs \$60 to purchase XYZ in the market. Because each option contract controls 100 shares of the underlying stock, the intrinsic value, which was calculated on a per share basis, is multiplied by 100, resulting in an aggregate intrinsic value of \$1,000 for the May2011 50 call.³ However, because the May2011 50 call is short, the \$1,000 intrinsic value is a loss, because it represents the cost to close (i.e., buy-back) the short option. At an assumed XYZ market price of \$60, netting the intrinsic values of the options results in a loss of \$1,000 ($-\$1,000 + 0$).⁴ Therefore, the maximum risk of, and margin requirement for, this spread is \$1,000. If there is no maximum risk (i.e., there is no loss calculated at any of the exercise prices found in the spread), no margin is required, but under Exchange margin rules any net debit incurred to establish the spread would be required to be paid for in full. Current CBOE Rule 12.3(c)(5)(C)(4) provides that, when the exercise price of the long call (or short put) is less than or equal to the exercise price of the offsetting short call (or long put), no margin is required; and that when the exercise price of the long call (or short put) is greater than the exercise price of the offsetting short call (or long put) the amount of margin required is the lesser of the margin requirement on the short option, if treated as

³ The result would be multiplied by the number of contracts when more than a one-by-one contract spread is involved.

⁴ At an assumed market price of \$50, both the May2011 50 call and May2011 60 call would have no intrinsic value. Thus, there is no risk (provided any net debit is paid for in full) at an assumed market price of \$50.

uncovered, or the difference in the aggregate exercise prices. The intrinsic value calculation described above is essentially expressed, in different words, in the current rule language.

The maximum risk remains constant at \$1,000 for XYZ market prices higher than \$60 because for each incremental increase in the assumed market price of XYZ above \$60, the loss on the short option is equally offset by a gain on the long option in terms of their intrinsic values. By calculating the net intrinsic value of the options at each exercise price found in the spread, as in the computation exemplified above, the maximum risk of, and margin requirement for, any two-legged spread can be determined.

On August 23, 1999, the Exchange implemented specific definitions and margin requirements for butterfly spreads and box spreads.⁵ In a butterfly spread, a two-legged spread is combined with a second two-legged spread (same type – put or call – and same underlying security) as in the following example:

Long 1 XYZ May2011 50 call
Short 1 XYZ May2011 60 call

Long 1 XYZ May2011 70 call
Short 1 XYZ May2011 60 call

Note that a short XYZ May2011 60 call option is common to both two-legged spreads.

Therefore, by adding the May2011 60 call options together, the two spreads can be combined to form a butterfly spread as follows:

⁵ The butterfly and box spread margin rules, and various other CBOE margin rule changes, were approved by the Securities and Exchange Commission on July 27, 1999. See Securities Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736. SR-CBOE-97-67.

Long 1 XYZ May2011 50 call
 Short 2 XYZ May2011 60 calls
 Long 1 XYZ May2010 70 call⁶

The margin requirement for a butterfly spread is its maximum risk. The maximum risk can be determined in the same manner as demonstrated above for two-legged spreads. In this example, the net intrinsic values would be calculated at assumed prices for the underlying of \$50, \$60 and \$70, which are the exercise prices found in the butterfly spread. The greatest loss, if any, from among the net intrinsic values is the margin requirement. For this particular butterfly spread, there is no loss in terms of net intrinsic values at any of the assumed underlying prices (\$50, \$60 or \$70). Therefore, there is no margin requirement. However, the net debit incurred to establish this butterfly spread must be paid for in full.

In a box spread, a two-legged call spread is combined with a two-legged put spread. The exercise prices of the long and short put options are the reverse of the call spread. All options have the same underlying security and expiration date. An example is as follows:

Long 1 XYZ May2011 50 call
 Short 1 XYZ May2011 60 call

Long 1 XYZ May2011 60 put
 Short 1 XYZ May2011 50 put⁷

⁶ This configuration represents a long butterfly spread. The opposite (i.e., short 1 XYZ May2011 50 call, long 2 XYZ May2011 60 calls and short 1 XYZ May2011 70 call) would be a short butterfly spread.

⁷ This configuration represents a long box spread. The opposite (i.e., short 1 XYZ May2011 50 call, long 1 XYZ May2011 60 call, short 1 May2011 60 put and long 1 XYZ May2011 50 put) would be a short box spread.

The margin requirement for a box spread, unless all options are European style, is its maximum risk. The maximum risk of a box spread can be determined in the same manner as demonstrated above for two-legged spreads and butterfly spreads. In this example, the net intrinsic values would be calculated at assumed prices for the underlying of \$50 and \$60, which are the exercise prices found in the box spread. The greatest loss, if any, from among the net intrinsic values is the margin requirement. For this particular box spread (long box spread), there is no loss in terms of net intrinsic values at either of the assumed underlying prices (\$50 or \$60). Therefore, there is no margin requirement. However, the net debit incurred to establish this box spread must be paid for in full. In the case of a long box spread where all options are European style, the margin requirement is 50% of the difference in the exercise prices (in aggregate).⁸

On August 13, 2003, the Exchange issued a Regulatory Circular (RG03-066) to define additional types of multi-leg option spreads, and to set margin requirements for these spreads through interpretation of Exchange margin rules. The Regulatory Circular had been filed with the Securities and Exchange Commission and was approved on August 8, 2003, on a one year pilot basis.⁹ The Regulatory Circular was reissued as RG04-90 (dated August 16, 2004) and RG05-37 (dated April 6, 2005) pursuant to one year extensions of the pilot granted by the Securities and Exchange Commission

⁸ A 50% margin requirement is allowed because a long box spread has an intrinsic value at expiration equal to the difference in the exercise prices (in aggregate), which will more than cover the net debit incurred to establish the spread. A long box spread is, essentially, a riskless position. The difference between the value of the long box spread realizable at expiration and the lower cost to establish the spread represents a risk-free rate of return.

⁹ See Securities Exchange Act Release No. 48306 (Aug. 8, 2003), 68 FR 48974 (Aug. 15, 2003). SR-CBOE-2003-24.

on August 6, 2004, and March 22, 2005, respectively.¹⁰

The Regulatory Circular identified seven spread strategies by presenting an example of each spread's configuration, and numbering each configuration, rather than designating the configurations by names commonly used in the industry. The seven configurations would be referred to in the industry as:

Long Condor Spread,
Short Iron Butterfly Spread,
Short Iron Condor Spread,
Long Calendar Butterfly Spread,
Long Calendar Condor Spread,
Short Calendar Iron Butterfly Spread and
Short Calendar Iron Condor Spread.

On July 30, 2004, the Exchange filed proposed rule amendments with the Securities and Exchange Commission to codify the provisions of the Regulatory Circular in Exchange margin rules. Included in the proposal were definitions of Long Condor Spread (which includes a Long Calendar Condor Spread), Short Iron Butterfly Spread (which includes a Short Calendar Iron Butterfly Spread), and Short Iron Condor Spread (which includes a Short Calendar Iron Condor Spread). In addition, it was proposed that the existing definition of Long Butterfly Spread be amended to include a Long Calendar Butterfly Spread. The margin requirements, specific to each type of spread, as had been set-forth in the Regulatory Circulars, were also proposed for inclusion in Exchange margin rules.¹¹ Contemporaneously, the New York Stock Exchange filed similar margin

¹⁰ See Securities Exchange Act Release No. 50164 (Aug. 6, 2004), 69 FR 50405 (Aug. 16, 2004) and Securities Exchange Act Release No. 51407 (Mar. 22, 2005), 70 FR 15669 (Mar. 28, 2005).

¹¹ See Securities Exchange Act Release No. 52739 (Nov. 4, 2005), 70 FR 69173 (Nov. 14, 2005). SR-CBOE-2004-53. This release also noticed a partial amendment (Amendment No. 1) that was filed on

rule proposals with Commission.¹² CBOE's proposed rule amendment was approved by the Commission on December 14, 2005.¹³

Because a number of variations are possible for each basic type of multi-leg option spread strategy, it is problematic to maintain margin rules specific to each.¹⁴ It becomes difficult to continually designate each variation by name, and define and specify a margin requirement for it in the rules. For example, consider the following spreads:

Long 10 XYZ May2011 50 call
Short 10 XYZ May2011 55 call

Long 5 XYZ May2010 70 call
Short 5 XYZ May2011 60 call

These two spreads combined are a variation of a condor spread. In a basic condor spread, the number of option contracts would be equal across all option series and the interval between the exercise prices of each spread would be equal. In the above variation, there is a 10-by-10 contract spread vs. a 5-by-5 contract spread, and a spread with a 5 point interval between exercise prices vs. a spread with a 10 point interval between exercise prices. The two spreads in the above example offset each other in terms of risk, and no margin requirement is necessary. However, margin of \$5,000 is required

August 23, 2005 (in coordination with the New York Stock Exchange).

¹² See Securities Exchange Act Release No. 52738 (Nov. 4, 2005), 70 FR 68501 (Nov. 10, 2005). SR-NYSE-2004-39. For approval order, see Securities Exchange Act Release No. 52951 (Dec. 14, 2005), 70 FR 75523 (Dec. 20, 2005).

¹³ See Securities Exchange Act Release 52950 (Dec. 14, 2005), 70 FR 75512 (Dec. 20, 2005).

¹⁴ A long calendar butterfly spread is an example of a variation. The basic type would be butterfly spread. In a long calendar butterfly spread, one of the long options expires after the other two options expire concurrently, whereas in the basic butterfly spread, all options expire concurrently. Another example of a variation of a butterfly spread would be a configuration where the intervals between the exercise prices involved are not equal. In a basic butterfly spread, the intervals are equal (i.e., symmetric).

under the Exchange's current margin rules, because this variation of the condor spread is not specified in the rules. Because it is not recognized in Exchange margin rules, the two spreads must be treated as separate, unrelated spread strategies for margin purposes. As a result, spread margin of \$5,000 is required (on the May2011 70 / May2010 60 call spread) versus no requirement (other than pay for the net debit in full), if the two spreads could be recognized as one strategy.

This rule filing proposes a single, universal definition of a spread and one spread margin requirement that consists of a universal margin requirement computation methodology. In this manner, the margin requirement for all types of option spreads would be covered by a single rule, without regard to the number of option series involved or the term commonly used in the industry to refer to the spread. This would eliminate the need to define, and refer to, particular spreads by monikers commonly used in the industry. Therefore, this rule filing proposes to eliminate definitions of each particular spread strategy (e.g., butterfly, condor, iron butterfly, iron condor, etc.), with one exception.

The one exception would be "Box Spreads." A definition for "Box Spread" would be retained because loan value is permitted under Exchange margin rules for box spreads. Box spreads are the only type of spread that is eligible for loan value. They, therefore, need to be specially identified in the rules.

Additionally, the proposed rule changes would automatically enable variations not currently recognized in Exchange margin rules (because only a limited number of specific spread strategies are defined) to receive spread margin treatment.

A new definition of a spread is proposed as Rule 12.3(a)(5). The key to the definition is that it designates a spread as being an equivalent long and short position in different call option series and/or equivalent long and short positions in different put option series, or a combination thereof.¹⁵ With respect to equivalency of long and short positions, the definition further requires that the long and short positions be equal in terms of the aggregate value of the underlying security or instrument covered by each leg. The aggregate value equivalency is included so that it is clear that a spread composed of one standard option contract and one reduced value option contract covering the same underlying security or instrument would be permissible. For example, if reduced value options, equal to 1/10th the value of a standard option contract are trading, a spread consisting of 10 reduced value contracts vs. one standard contract would be permissible.¹⁶ As with spreads under the current rule, the proposed rule further requires that the short option(s) expire after, or at the same time as, the long option(s). Additionally, under the proposed rule definition, all options in a spread must have the same exercise style (American or European) and either be composed of all listed options or all over-the-counter (OTC) options. Spreads that do not conform to the definition would be ineligible for spread margin treatment.

¹⁵ An option series means particular exercise price **and** expiration date with respect to a put or call option.

¹⁶ Currently, spreads consisting of standard contracts and reduced value contracts are permitted by the rules, although the current rule does not go into detail to require equivalent aggregate underlying value between the long and short legs.

Amendments to CBOE Rule 12.3(c)(5)(C)(4) are proposed to implement language specifying how a margin requirement is to be computed for any spread that meets the definition, and limit eligibility for spread margin treatment to spreads that meet the definition. The computational method would require that the intrinsic value of each option series contained in a spread be calculated for assumed prices of the underlying security or instrument. The exercise prices of the option series contained in the spread would be required to be used as the assumed prices of the underlying security or instrument. For each assumed price of the underlying, the intrinsic values would be netted. The greatest loss from among the netted intrinsic values would be the spread margin requirement. As an example, consider the following spread:

Long 1 XYZ May2011 50 put
Short 1 XYZ May2011 60 put
Short 1 XYZ May2011 65 call
Long 1 XYZ May2011 70 call

This spread is a variation of an iron condor spread. It consists of a put spread and a call spread, with all options covering the same underlying security or instrument. There are an equal number of contracts long and short in both the put spread and call spread. The short options expire with or after the long options (with, in this case). It is assumed that all options are of the same exercise style (American or European). This spread would, therefore, be eligible for the spread margin requirement computation in this proposed rule amendment.

Note that in this example, the interval between the exercise prices in the put spread is greater than the interval in the call spread. In a basic iron condor spread, these intervals

are equal. This particular configuration is not recognized under current Exchange margin rules. Therefore the component put spread and call spread must be viewed as separate, unrelated strategies for margin purposes. Under current Exchange margin rules, there is a \$1,000 margin requirement on the put spread and \$500 margin requirement on the call spread. However, there are offsetting properties between the two spreads, and, if viewed collectively, a total margin requirement of \$1,500 is not necessary. Using the proposed computational methodology, a margin requirement would be calculated as follows:

<u>SPREAD</u>	INTRINSIC VALUES for ASSUMED PRICES of the UNDERLYING			
	<u>\$50</u>	<u>\$60</u>	<u>\$65</u>	<u>\$70</u>
Long 1 XYZ May2011 50 put	0	0	0	0
Short 1 XYZ May2011 60 put	\$(1,000)	0	0	0
Short 1 XYZ May2011 65 call	0	0	0	\$(500)
Long 1 XYZ May2011 70 call	0	0	0	0
Net intrinsic values	\$(1,000)	0	0	\$(500)

The greatest loss from among the netted intrinsic values is \$1,000.¹⁷ Under the proposed rule amendments, this would be the margin requirement. This spread margin requirement is \$500 less than that required under current Exchange margin rules. Note that under both the current and proposed rules, any net debit incurred when establishing the spread is required to be paid for in full.

It can be intuitively shown that the put spread and call spread in the example do not have \$1,500 of risk when viewed collectively. If the price of the underlying is at or above \$60, the put spread would have no intrinsic value. At or below \$65, the call spread

¹⁷ Again, depending on the type of spread strategy, there may be no loss among the netted intrinsic values, in which case there would be no margin requirement.

would have no intrinsic value. Thus, both spreads would never be at risk at any given price of the underlying. Therefore, margin need be required on only one of the spreads – the one with the highest risk. In this example, the put spread has the highest risk (\$1,000), and that is the risk (and margin requirement) that would be rendered by the proposed computational methodology.

In summary, the proposed rule amendments would enable the Exchange, for margin purposes, to accommodate the many types of spread strategies utilized in the industry today in a fair and efficient manner.

(b) Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)¹⁸ of the Securities Exchange Act of 1934 (the "Act") and the rules and regulations under the Act, in general, and furthers the objectives of Section 6(b)(5).¹⁹ Because this rule filing proposes a single, universal definition of a spread and one spread margin requirement that consists of a universal margin requirement computation methodology, it promotes just and equitable principles of trade and fosters cooperation and coordination with persons engaged in facilitating transactions in securities. By adding clarity and consistency to margin requirements, it also removes impediments to and perfects the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest.

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

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 specified in Section 19(b)(2) of the Act²⁰ 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) or Section 19(b)(7)(D)

Not applicable.

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

Not applicable.

Item 9. Exhibits

²⁰ 15 U.S.C. 78s(b)(2).

Exhibit 1. Completed Notice of Proposed Rule Change for publication in the
Federal Register.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34- ; File No. SR-CBOE-2012-043]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to Spread Margin Rules

[Insert date]

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 [insert date], 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

This filing proposes universal spread margin rules. The text of the proposed rule change is available on the Exchange’s Web site (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), 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 Exchange 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 these statements may be examined at the places

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

An option spread is typically characterized by the simultaneous holding of a long and short option of the same type (put or call) where both options overly the same security or instrument, but have different exercise prices and/or expirations. To be eligible for spread margin treatment, the long option may not expire before the short option. These long put/short put or long call/short call spreads are known as two-legged spreads.

Since the inception of the Exchange, the margin requirements for two-legged spreads have been specified in CBOE margin rules.³ The margin requirement for a two-legged spread that is eligible for spread margin treatment is its maximum risk based on the intrinsic values of the options, exclusive of any net option premiums paid or received when the positions were established.⁴ For example, consider the following equity option spread:

Long 1 XYZ May2011 60 call	Short 1
XYZ May2011 50 call	

The maximum potential loss (i.e., risk) for this particular spread would be a scenario where the price of the underlying stock (XYZ) is \$60 or higher. If the market price of XYZ is \$60, the May2011 60 call would have an intrinsic value of zero, because the right to buy at \$60 when XYZ can be purchased in the market for \$60 has no intrinsic value. The May2011 50 call would have an intrinsic value of \$10 because of the \$10 advantage gained by being able to buy at \$50 when it costs \$60 to purchase XYZ in the market. Because each option contract controls 100 shares of the underlying stock, the intrinsic value, which was calculated on a per share basis, is

³ Chapter 12. Rule 12.3(c)(5)(C)(4).

⁴ Any net credit received for establishing a spread may be applied to the margin requirement, if any. In the case of a spread that is established for a net debit, the net debit must be paid for in full.

multiplied by 100, resulting in an aggregate intrinsic value of \$1,000 for the May2011 50 call.⁵ However, because the May2011 50 call is short, the \$1,000 intrinsic value is a loss, because it represents the cost to close (i.e., buy-back) the short option. At an assumed XYZ market price of \$60, netting the intrinsic values of the options results in a loss of \$1,000 ($-\$1,000 + 0$).⁶ Therefore, the maximum risk of, and margin requirement for, this spread is \$1,000. If there is no maximum risk (i.e., there is no loss calculated at any of the exercise prices found in the spread), no margin is required, but under Exchange margin rules any net debit incurred to establish the spread would be required to be paid for in full. Current CBOE Rule 12.3(c)(5)(C)(4) provides that, when the exercise price of the long call (or short put) is less than or equal to the exercise price of the offsetting short call (or long put), no margin is required; and that when the exercise price of the long call (or short put) is greater than the exercise price of the offsetting short call (or long put) the amount of margin required is the lesser of the margin requirement on the short option, if treated as uncovered, or the difference in the aggregate exercise prices. The intrinsic value calculation described above is essentially expressed, in different words, in the current rule language.

The maximum risk remains constant at \$1,000 for XYZ market prices higher than \$60 because for each incremental increase in the assumed market price of XYZ above \$60, the loss on the short option is equally offset by a gain on the long option in terms of their intrinsic values. By calculating the net intrinsic value of the options at each exercise price found in the spread, as in the computation exemplified above, the maximum risk of, and margin requirement for, any two-legged spread can be determined.

⁵ The result would be multiplied by the number of contracts when more than a one-by-one contract spread is involved.

⁶ At an assumed market price of \$50, both the May2011 50 call and May2011 60 call would have no intrinsic value. Thus, there is no risk (provided any net debit is paid for in full) at an assumed market price of \$50.

On August 23, 1999, the Exchange implemented specific definitions and margin requirements for butterfly spreads and box spreads.⁷ In a butterfly spread, a two-legged spread is combined with a second two-legged spread (same type – put or call – and same underlying security) as in the following example:

Long 1 XYZ May2011 50 call
Short 1 XYZ May2011 60 call

Long 1 XYZ May2011 70 call
Short 1 XYZ May2011 60 call

Note that a short XYZ May2011 60 call option is common to both two-legged spreads. Therefore, by adding the May2011 60 call options together, the two spreads can be combined to form a butterfly spread as follows:

Long 1 XYZ May2011 50 call
Short 2 XYZ May2011 60 calls
Long 1 XYZ May2011 70 call⁸

The margin requirement for a butterfly spread is its maximum risk. The maximum risk can be determined in the same manner as demonstrated above for two-legged spreads. In this example, the net intrinsic values would be calculated at assumed prices for the underlying of \$50, \$60 and \$70, which are the exercise prices found in the butterfly spread. The greatest loss, if any, from among the net intrinsic values is the margin requirement. For this particular butterfly spread, there is no loss in terms of net intrinsic values at any of the assumed underlying prices (\$50, \$60 or \$70). Therefore, there is no margin requirement. However, the net debit incurred to establish this butterfly spread must be paid for in full.

In a box spread, a two-legged call spread is combined with a two-legged put

⁷ The butterfly and box spread margin rules, and various other CBOE margin rule changes, were approved by the Securities and Exchange Commission on July 27, 1999. See Securities Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736. SR-CBOE-97-67.

⁸ This configuration represents a long butterfly spread. The opposite (i.e., short 1 XYZ May2011 50 call, long 2 XYZ May2011 60 calls and short 1 XYZ May2011 70 call) would be a short butterfly spread.

spread. The exercise prices of the long and short put options are the reverse of the call spread. All options have the same underlying security and expiration date. An example is as follows:

Long 1 XYZ May2011 50 call

Short 1 XYZ May2011 60 call

Long 1 XYZ May2011 60 put

Short 1 XYZ May2011 50 put⁹

The margin requirement for a box spread, unless all options are European style, is its maximum risk. The maximum risk of a box spread can be determined in the same manner as demonstrated above for two-legged spreads and butterfly spreads. In this example, the net intrinsic values would be calculated at assumed prices for the underlying of \$50 and \$60, which are the exercise prices found in the box spread. The greatest loss, if any, from among the net intrinsic values is the margin requirement. For this particular box spread (long box spread), there is no loss in terms of net intrinsic values at either of the assumed underlying prices (\$50 or \$60). Therefore, there is no margin requirement. However, the net debit incurred to establish this box spread must be paid for in full. In the case of a long box spread where all options are European style, the margin requirement is 50% of the difference in the exercise prices (in aggregate).¹⁰

On August 13, 2003, the Exchange issued a Regulatory Circular (RG03-066) to define additional types of multi-leg option spreads, and to set margin requirements for these spreads through interpretation of Exchange margin rules. The Regulatory Circular had been filed with the Securities and Exchange Commission and was approved on August 8, 2003, on a one

⁹ This configuration represents a long box spread. The opposite (i.e., short 1 XYZ May2011 50 call, long 1 XYZ May2011 60 call, short 1 May2011 60 put and long 1 XYZ May2011 50 put) would be a short box spread.

¹⁰ A 50% margin requirement is allowed because a long box spread has an intrinsic value at expiration equal to the difference in the exercise prices (in aggregate), which will more than cover the net debit incurred to establish the spread. A long box spread is, essentially, a riskless position. The difference between the value of the long box spread realizable at expiration and the lower cost to establish the spread represents a risk-free rate of return.

year pilot basis.¹¹ The Regulatory Circular was reissued as RG04-90 (dated August 16, 2004) and RG05-37 (dated April 6, 2005) pursuant to one year extensions of the pilot granted by the Securities and Exchange Commission

on August 6, 2004, and March 22, 2005, respectively.¹²

The Regulatory Circular identified seven spread strategies by presenting an example of each spread's configuration, and numbering each configuration, rather than designating the configurations by names commonly used in the industry. The seven configurations would be referred to in the industry as:

Long Condor Spread,
Short Iron Butterfly Spread,
Short Iron Condor Spread,
Long Calendar Butterfly Spread,
Long Calendar Condor Spread,
Short Calendar Iron Butterfly Spread and
Short Calendar Iron Condor Spread.

On July 30, 2004, the Exchange filed proposed rule amendments with the Securities and Exchange Commission to codify the provisions of the Regulatory Circular in Exchange margin rules. Included in the proposal were definitions of Long Condor Spread (which includes a Long Calendar Condor Spread), Short Iron Butterfly Spread (which includes a Short Calendar Iron Butterfly Spread), and Short Iron Condor Spread (which includes a Short Calendar Iron Condor Spread). In addition, it was proposed that the existing definition of Long Butterfly Spread be amended to include a Long Calendar Butterfly Spread. The margin requirements, specific to each type of spread, as had been set-forth in the Regulatory Circulars, were also proposed for inclusion in Exchange margin rules.¹³ Contemporaneously, the New York Stock Exchange filed similar

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¹² See Securities Exchange Act Release No. 50164 (Aug. 6, 2004), 69 FR 50405 (Aug. 16, 2004) and Securities Exchange Act Release No. 51407 (Mar. 22, 2005), 70 FR 15669 (Mar. 28, 2005).

¹³ See Securities Exchange Act Release No. 52739 (Nov. 4, 2005), 70 FR 69173 (Nov. 14, 2005). SR-CBOE-2004-53. This release also noticed a partial amendment (Amendment No. 1) that was filed on

margin rule proposals with Commission.¹⁴ CBOE's proposed rule amendment was approved by the Commission on December 14, 2005.¹⁵

Because a number of variations are possible for each basic type of multi-leg option spread strategy, it is problematic to maintain margin rules specific to each.¹⁶ It becomes difficult to continually designate each variation by name, and define and specify a margin requirement for it in the rules. For example, consider the following spreads:

Long 10 XYZ May2011 50 call
Short 10 XYZ May2011 55 call

Long 5 XYZ May2010 70 call
Short 5 XYZ May2011 60 call

These two spreads combined are a variation of a condor spread. In a basic condor spread, the number of option contracts would be equal across all option series and the interval between the exercise prices of each spread would be equal. In the above variation, there is a 10-by-10 contract spread vs. a 5-by-5 contract spread, and a spread with a 5 point interval between exercise prices vs. a spread with a 10 point interval between exercise prices. The two spreads in the above example offset each other in terms of risk, and no margin requirement is necessary. However, margin of \$5,000 is required under the Exchange's current margin rules, because this variation of the condor spread is not specified in the rules. Because it is not recognized in Exchange margin rules, the two spreads must be treated as separate, unrelated

August 23, 2005 (in coordination with the New York Stock Exchange).

¹⁴ See Securities Exchange Act Release No. 52738 (Nov. 4, 2005), 70 FR 68501 (Nov. 10, 2005). SR-NYSE-2004-39. For approval order, see Securities Exchange Act Release No. 52951 (Dec. 14, 2005), 70 FR 75523 (Dec. 20, 2005).

¹⁵ See Securities Exchange Act Release 52950 (Dec. 14, 2005), 70 FR 75512 (Dec. 20, 2005).

¹⁶ A long calendar butterfly spread is an example of a variation. The basic type would be butterfly spread. In a long calendar butterfly spread, one of the long options expires after the other two options expire concurrently, whereas in the basic butterfly spread, all options expire concurrently. Another example of a variation of a butterfly spread would be a configuration where the intervals between the exercise prices involved are not equal. In a basic butterfly spread, the intervals are equal (i.e., symmetric).

spread strategies for margin purposes. As a result, spread margin of \$5,000 is required (on the May2011 70 / May2010 60 call spread) versus no requirement (other than pay for the net debit in full), if the two spreads could be recognized as one strategy.

This rule filing proposes a single, universal definition of a spread and one spread margin requirement that consists of a universal margin requirement computation methodology. In this manner, the margin requirement for all types of option spreads would be covered by a single rule, without regard to the number of option series involved or the term commonly used in the industry to refer to the spread. This would eliminate the need to define, and refer to, particular spreads by monikers commonly used in the industry. Therefore, this rule filing proposes to eliminate definitions of each particular spread strategy (e.g., butterfly, condor, iron butterfly, iron condor, etc.), with one exception.

The one exception would be “Box Spreads.” A definition for “Box Spread” would be retained because loan value is permitted under Exchange margin rules for box spreads. Box spreads are the only type of spread that is eligible for loan value. They, therefore, need to be specially identified in the rules.

Additionally, the proposed rule changes would automatically enable variations not currently recognized in Exchange margin rules (because only a limited number of specific spread strategies are defined) to receive spread margin treatment.

A new definition of a spread is proposed as Rule 12.3(a)(5). The key to the definition is that it designates a spread as being an equivalent long and short position in different call option series and/or equivalent long and short positions in different put option series, or a combination

thereof.¹⁷ With respect to equivalency of long and short positions, the definition further requires that the long and short positions be equal in terms of the aggregate value of the underlying security or instrument covered by each leg. The aggregate value equivalency is included so that it is clear that a spread composed of one standard option contract and one reduced value option contract covering the same underlying security or instrument would be permissible. For example, if reduced value options, equal to 1/10th the value of a standard option contract are trading, a spread consisting of 10 reduced value contracts vs. one standard contract would be permissible.¹⁸ As with spreads under the current rule, the proposed rule further requires that the short option(s) expire after, or at the same time as, the long option(s). Additionally, under the proposed rule definition, all options in a spread must have the same exercise style (American or European) and either be composed of all listed options or all over-the-counter (OTC) options. Spreads that do not conform to the definition would be ineligible for spread margin treatment.

Amendments to CBOE Rule 12.3(c)(5)(C)(4) are proposed to implement language specifying how a margin requirement is to be computed for any spread that meets the definition, and limit eligibility for spread margin treatment to spreads that meet the definition. The computational method would require that the intrinsic value of each option series contained in a spread be calculated for assumed prices of the underlying security or instrument. The exercise prices of the option series contained in the spread would be required to be used as the assumed prices of the underlying security or instrument. For each assumed price of the underlying, the intrinsic values would be netted. The greatest loss from among the netted intrinsic values would be the spread margin requirement. As an example, consider the following spread:

¹⁷ An option series means particular exercise price **and** expiration date with respect to a put or call option.

¹⁸ Currently, spreads consisting of standard contracts and reduced value contracts are permitted by the rules, although the current rule does not go into detail to require equivalent aggregate underlying value between the long and short legs.

Long 1 XYZ May2011 50 put
 Short 1 XYZ May2011 60 put
 Short 1 XYZ May2011 65 call
 Long 1 XYZ May2011 70 call

This spread is a variation of an iron condor spread. It consists of a put spread and a call spread, with all options covering the same underlying security or instrument. There are an equal number of contracts long and short in both the put spread and call spread. The short options expire with or after the long options (with, in this case). It is assumed that all options are of the same exercise style (American or European). This spread would, therefore, be eligible for the spread margin requirement computation in this proposed rule amendment.

Note that in this example, the interval between the exercise prices in the put spread is greater than the interval in the call spread. In a basic iron condor spread, these intervals are equal. This particular configuration is not recognized under current Exchange margin rules. Therefore the component put spread and call spread must be viewed as separate, unrelated strategies for margin purposes. Under current Exchange margin rules, there is a \$1,000 margin requirement on the put spread and \$500 margin requirement on the call spread. However, there are offsetting properties between the two spreads, and, if viewed collectively, a total margin requirement of \$1,500 is not necessary. Using the proposed computational methodology, a margin requirement would be calculated as follows:

INTRINSIC VALUES for ASSUMED		PRICES of the UNDERLYING	
<u>SPREAD</u>		\$50	\$70
\$60	\$65		
Long 1 XYZ May2011 50 put			0
0	0	0	
Short 1 XYZ May2011 60 put \$(1,000)	0		0
	0		
Short 1 XYZ May2011 65 call			0

		0		
0			\$(500)	
Long 1 XYZ May2011 70 call				0
		0		
0			0	
Net intrinsic values			0	
	\$(1,000)			
0			\$(500)	

The greatest loss from among the netted intrinsic values is \$1,000.¹⁹ Under the proposed rule amendments, this would be the margin requirement. This spread margin requirement is \$500 less than that required under current Exchange margin rules. Note that under both the current and proposed rules, any net debit incurred when establishing the spread is required to be paid for in full.

It can be intuitively shown that the put spread and call spread in the example do not have \$1,500 of risk when viewed collectively. If the price of the underlying is at or above \$60, the put spread would have no intrinsic value. At or below \$65, the call spread would have no intrinsic value. Thus, both spreads would never be at risk at any given price of the underlying. Therefore, margin need be required on only one of the spreads – the one with the highest risk. In this example, the put spread has the highest risk (\$1,000), and that is the risk (and margin requirement) that would be rendered by the proposed computational methodology.

In summary, the proposed rule amendments would enable the Exchange, for margin purposes, to accommodate the many types of spread strategies utilized in the industry today in a fair and efficient manner.

¹⁹ Again, depending on the type of spread strategy, there may be no loss among the netted intrinsic values, in which case there would be no margin requirement.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)²⁰ of the Securities Exchange Act of 1934 (the "Act") and the rules and regulations under the Act, in general, and furthers the objectives of Section 6(b)(5).²¹ Because this rule filing proposes a single, universal definition of a spread and one spread margin requirement that consists of a universal margin requirement computation methodology, it promotes just and equitable principles of trade and fosters cooperation and coordination with persons engaged in facilitating transactions in securities. By adding clarity and consistency to margin requirements, it also removes impediments to and perfects the mechanisms of 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 that is 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 proposed rule change.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date

²⁰ 15 U.S.C. 78f(b).

²¹ 15 U.S.C. 78f(b)(5).

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 or disapprove such proposed rule change, or

B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2012-043 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2012-043. 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 Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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-2012-043 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.²²

Secretary

²² 17 CFR 200.30-3(a)(12).