Number SR–NASDAQ–2010–007 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–NASDAQ–2010–007. 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 a.m. and 3 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 publicly available. All submissions should refer to File Number SR–NASDAQ–2010–007 and should be submitted on or before February 25, 2010.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[17]

Florence E. Harmon,

Deputy Secretary.

[FR Doc. 2010–2337 Filed 2–3–10; 8:45 am]

BILLING CODE 8011–01–P

[17] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–61439; File No. SR–CBOE–2009–087]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change To Establish a Pilot Program To Modify FLEX Option Exercise Settlement Values and Minimum Value Sizes

January 28, 2010.

On December 3, 2009, Chicago Board Options Exchange, Incorporated ("CBOE") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b–4 thereunder,[2] a proposed rule change to establish a pilot program to modify exercise settlement values and minimum value sizes for Flexible Exchange Options ("FLEX Options").[3] The proposed rule change was published for comment in the **Federal Register** on December 24, 2009.[4] The Commission received six comments regarding the proposal. One commenter provided background information about financial derivatives as they related to variable annuity products,[5] and five commenters supported the proposed rule change.[6]

The Exchange is proposing two pilots with this proposed rule change. First, CBOE is proposing to implement a fourteen-month pilot program to permit p.m. and specified average price settlements of FLEX Index Options that expire on, or within two business days of, a third-Friday-of-the-month expiration ("Blackout Period").[7] Under current FLEX Option rules, only a.m. settlements based on opening prices of the underlying components of an index can be used to settle a FLEX Index Option if it expires within the Blackout Period. In its proposal, CBOE has stated that, at least two months prior to the expiration of the pilot program, it will provide the Commission with an annual report analyzing volume and open interest for each broad-based FLEX Index Options class overlying an Expiration Friday, p.m.-settled FLEX Index Options series.[8] The annual report will also contain information and analysis of FLEX Options trading patterns, and index price volatility and underlying share trading activity for each broad-based index class overlying an Expiration Friday, p.m.-settled FLEX Index Option that exceeds certain minimum open interest parameters.[9] The Exchange will also provide to the Commission, on a periodic basis, interim reports of volume and open interest.

CBOE also proposes to eliminate the minimum value size requirements for all FLEX Options on a fourteen-month pilot basis. CBOE will submit a pilot program report if it elects to extend or expand the pilot program, or to make the program permanent. The pilot program report would include data and analysis of open interest and trading volume, and analysis of the types of investors that initiated opening FLEX

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] A FLEX option is a customized option that provides parties to the transaction with the ability to fix terms including the exercise style, expiration date, and certain exercise prices. *See* CBOE Rule 24A.4(a). A FLEX Option may be either a FLEX Index Option or a FLEX Equity Option.

[4] *See* Securities Exchange Act Release No. 61183 (December 16, 2009), 74 FR 68435 ("Notice").

[5] *See* Letter to Elizabeth M. Murphy, Secretary, Commission, from Mark E. White, Assistant Superintendent, Regulation Sector, Office of the Superintendent of Financial Institutions Canada, dated January 7, 2010 (noting that the Office did "not feel comfortable making comments on the particular proposal," but wanted to "provide some information related to variable annuity products that the SEC may find helpful when considering the CBOE's submission.").

[6] *See* Submissions via SEC WebForm from Miller Blew, CEO, Safe Haven Advisors, LLC, dated January 12, 2010 (supporting proposal to eliminate minimum size requirements); Charles L. Gilbert, President, Nexus Risk Management, dated January 8, 2010 (supporting the elimination of the p.m. settlement restriction and minimum size requirements as a means to enable insurers to more effectively hedge their risks); Ram Kelkar, Capital Markets and Trading, Milliman, Inc., dated January 8, 2010 (the ability to use FLEX Options as a hedging tool for life insurers "should be enhanced by reducing the minimum size requirements and by allowing p.m. settlements for all days of the month"); Kannoo Ravindran, dated January 14, 2010 (stating that the elimination of the p.m. settlement restriction and minimum size requirements will contribute to more effective risk management by institutions); Donald C. Smyth, dated January 12, 2010 (noting that "the more flexibility/granulatity we have in terms of FLEX option dates with p.m. expirations and small minimum notionals (preferably $0), the more effectively we can [tailor] and use FLEX options for our [equity indexed annuity] hedging needs.").

[7] A third-Friday-of-the-month expiration is generally referred to as "Expiration Friday".

[8] The annual report would also contain analyses of volume and open interest for Expiration Friday Non-FLEX Index series, where a broad-based Non-FLEX Index class overlies the same index as an Expiration Friday, p.m.-settled FLEX Index option. *See* Notice, *supra* note 4, 74 FR at 68436.

[9] *See* Notice, *supra* note 4, 74 FR at 68437. Any positions established under the pilot would not be impacted by the expiration of the pilot. For example, a position in a p.m.-settled FLEX Index Option series that expires on Expiration Friday in January 2015 could be established during the 14-month pilot. If the pilot program were not extended, then the position could continue to exist. However, any further trading in the series would be restricted to transactions where at least one side of the trade is a closing transaction. The Exchange stated that it would notify members of this restriction in a circular to members. *See* Notice, *supra* note 4, 74 FR at 68436.

Equity and Index Options transactions.[10]

The Commission has carefully reviewed CBOE's proposed rule change and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange [11] and, in particular, Section 6(b)(5) of the Act,[12] which requires that an exchange have rules designed to 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 to protect investors and the public interest, to allow CBOE to conduct limited, and carefully monitored, pilots as proposed.

Since the Commission approved the initial listing and trading of FLEX Options in 1993,[13] it has been concerned about the adverse effects and impact of p.m. settlements upon market volatility and the operation of fair and orderly markets on the underlying cash market at or near the close of trading. For example, FLEX Index Options were initially approved by the Commission with the restriction that they could not expire during the Blackout Period, which the Commission believed would "diminish the impact that FLEX Options could have on the market." [14] When the Commission approved a proposed rule change allowing a.m.-settled FLEX Options to expire during the Blackout Period, it noted that requiring FLEX Index Options expiring during the Blackout Period to be a.m.-settled would "reduce the potential for adverse effects on the underlying component securities." [15]

The Commission's concern about the effect upon market volatility of p.m. settlements for FLEX Index Options during the Blackout Period remains. Nevertheless, the Commission agrees with the Exchange that allowing p.m. and averaged price settlements for FLEX Index Options during the Blackout Period may allow more market participants to benefit from trading customized-type options in the Exchange's FLEX Options market rather than the OTC market.

Moreover, the Commission believes that CBOE's proposed fourteen-month pilot will allow for the CBOE and the Commission to monitor the potential for adverse market effects. In particular, the Commission notes that CBOE will provide the Commission with both annual and interim reports analyzing volume and open interest for each broad-based FLEX Index Options class overlying an Expiration Friday, p.m.-settled FLEX Index Options series. The annual report will also contain information and analysis of FLEX Options trading patterns, and index price volatility and underlying share trading activity for series that exceed certain minimum interest parameters. This information will enable the Commission to evaluate whether allowing p.m. settlements for FLEX Index Options during the Blackout Period has resulted in increased market and price volatility in the underlying component stocks. Further, the Exchange's position reporting requirements,[16] along with the ongoing analysis of the pilot, should help the Exchange to monitor any potential risk from large p.m.-settled positions and take appropriate action if warranted.[17]

The Commission also believes that CBOE's proposal to eliminate minimum size requirements for all FLEX Options on a pilot basis is consistent with the Act. Historically, the intended customers of FLEX Options were institutional and high net worth customers, rather than retail customers.[18] Although eliminating minimum size requirements raises the possibility that retail customers will access the FLEX Options market, the Commission received several comment letters noting that this proposal would assist institutional customers, such as insurance companies.[19]

As noted above, the Exchange will be monitoring the type of customers initiating opening FLEX Options transactions as part of the minimum size pilot over its fourteen-month period. In the event the Exchange elects to extend, expand or make the minimum-size pilot permanent, this information will enable the Commission to evaluate how market participants have responded to this proposal, and what types of customers are using the FLEX Options market.

Finally, we note that the combination of eliminating restrictions on settlement values during the Blackout Period, together with reducing the minimum size, increases the potential for the FLEX Options market to act as a surrogate for the non-FLEX Options market. The Commission has previously expressed concern that the FLEX Options market not act as a surrogate for trading in standardized options, especially because the standardized options market contains certain protections for investors. For example, because the FLEX Options market is designed to contain the benefits of an auction market with the features of negotiated transactions, continuous quotes may not always be available.[20] In addition, due to their customized nature, FLEX Options do not have trading rotations at either the opening or closing of trading.[21] The p.m. settlement and minimum size pilot information should help the Commission assess the impact on these markets as well as on the standardized market and determine whether other changes are necessary.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR–CBOE–2009–087) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[22]

Florence E. Harmon,

Deputy Secretary.

[FR Doc. 2010–2336 Filed 2–3–10; 8:45 am]

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[10] Any positions established under this pilot would not be impacted by the expiration of the pilot. For example, a 10-contract FLEX Equity Option opening position that overlies less than $1 million in the underlying security and expires in January 2015 could be established during the 14-month pilot. If the pilot program were not extended, then the position could continue to exist and any further trading in the series would be subject to the minimum value size requirements for continued trading in that series. *See* Notice, *supra* note 4, 74 FR at 68437.

[11] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[12] 15 U.S.C. 78f(b)(5).

[13] *See* Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993) (SR–CBOE–92–17).

[14] *Id.*

[15] *See* Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (SR–CBOE–2008–115).

[16] *See* CBOE Rule 24A.7; CBOE Rule 24B.7; *see also* CBOE Rule 4.13.

[17] As to the changes allowing settlement values to be a specified average price, the Commission notes that when it originally allowed for FLEX Options to expire with a.m. settlements in the Blackout Period, it was unsure what potential market impact specified averages would have because CBOE had not established any average price parameters. In the current proposal, CBOE states that average parameters would be limited to three alternatives.

[18] *See* Securities Exchange Act Release No. 57429 (March 4, 2008), 73 FR 13058 (March 11, 2008) (SR–CBOE–2006–36).

[19] *See, e.g.,* Submission via SEC WebForm from Ram Kelkar, Capital Markets and Trading, Milliman, Inc., dated January 8, 2010 (supporting the reduction of minimum size requirements and noting that "[t]he ability to hedge the risk for smaller notional amounts is vital for small and medium-size insurance companies and for smaller sized liability portfolios for large insurers.").

[20] *See* Securities Exchange Act Release No. 59417 (February 18, 2009), 74 FR 8591 (February 25, 2009) (SR–CBOE–2008–115).

[21] *See* Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993) (SR–CBOE–92–17).

[22] 17 CFR 200.30–3(a)(12).