

the underlying stock trades at \$6, the Exchange could list \$1 strikes from \$3 to \$11.¹³ The CBOE believes that this proposed range-format will significantly restrict the number of series that may be added at any one time.

Under existing Interpretation and Policy .01(a) to CBOE rule 5.5, the Exchange may list strike prices with \$2.50 intervals when an underlying stock trades below \$25. Accordingly, several option classes have \$7.50, \$12.50, and \$17.50 strike prices (the "\$2.50 series" or "\$2.50 intervals"). To further avoid the proliferation of series, the Exchange does not intend to list \$1 strike prices at levels that "bracket" existing \$2.50 intervals (e.g., \$7 and \$8 strikes around a \$7.50 strike). Accordingly, the Exchange does not intend to list \$7, \$8, \$12, \$13, \$17, and \$18 levels in an expiration month where there is a corresponding \$2.50 level. As the \$2.50 intervals are "phased-out," as described below, the Exchange would introduce the \$1 levels that bracket the phased-out price. For example, when the \$7.50 series expires, the Exchange would replace it by issuing a new month with \$7 and \$8 intervals.

Procedures for Phasing-out \$2.50 Strike Price Intervals: When a stock becomes part of the \$1 Strike Pilot Program, the Exchange will begin the corresponding process of phasing-out the existing \$2.50 intervals on the same stock in favor of \$1 intervals. To phase-out the \$2.50 intervals, the Exchange would first delist those \$2.50 series for which there is no open interest. Second, the Exchange would no longer add new expiration months at \$2.50 intervals below \$20 when the existing months expire. This would cause the \$2.50 strike price intervals below \$20 to be phased-out when the farthest-out month with a \$2.50 interval eventually expires.

\$1 Strikes for LEAPS: CBOE will not list LEAPS in equity option classes at \$1 strike price intervals.

Procedures for Adding Expiration Months: Interpretation and Policy .03 to CBOE rule 5.5 will govern the addition of expiration months for \$1 strike series. Pursuant to this rule, the Exchange generally opens up to four expiration months for each class upon initial listing of an options class for trading. Upon expiration of the near-term month, the Exchange may list an additional expiration month provided, however, that the underlying stock price closes below \$20 on its primary market on expiration Friday. If the underlying closes at or above \$20 on expiration

Friday, the Exchange would not list an additional month for a \$1 strike series until the stock again closes below \$20.

Procedures for Deleting \$1 Strike Price Intervals: At any time, the Exchange may cease listing \$1 strike prices on existing series by submitting a cessation notice to the Options Clearing Corporation ("OCC").¹⁴ As discussed above, if the underlying closes at or above \$20 on expiration Friday, the Exchange would not list any additional months with \$1 strike prices until the stock subsequently closed below \$20. If the underlying does not subsequently close below \$20, thereby precluding the listing of additional strike prices and months, the existing \$1 series will eventually expire. When the near-term month is the only series available for trading, the Exchange may submit a cessation notice to OCC. Upon submission of that notice, the underlying stock would no longer count towards the 5 stock Pilot Program, thereby allowing the Exchange to list classes on an additional stock. Once the Exchange submits the cessation notice, it would not list any additional months for trading with strikes below \$20 (unless the underlying once again closed below \$20).¹⁵

OPRA Capacity: CBOE represents that OPRA has the capacity to accommodate the increase in the number of series added pursuant to the Pilot Program. The Exchange notes that in December 2000 it listed approximately 109,000 series. By September 2001, this number declined almost 10% to approximately 100,000. The increase in the number of series quoted would be substantially below the 9,000 series decrease the CBOE experienced.

2. Statutory Basis

The Exchange believes that the addition of \$1 strike prices would stimulate customer interest in options overlying lower-priced stocks by creating greater trading opportunities and flexibility. The Exchange further believes that \$1 strike prices would provide customers with the ability to more closely tailor investment strategies to the precise movement of the

underlying security. For these reasons, the Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of section 6(b) of the Act.¹⁶ Specifically, the Exchange believes the proposed rule change is consistent with the section 6(b)(5)¹⁷ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were solicited or received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or,

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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

¹³ As indicated above, strike prices for options included in the Pilot Program may not be greater than \$20 or less than \$3.

¹⁴ Among the reasons for submitting a cessation notice are the expiration of available \$1 strikes (*i.e.*, underlying stock price remains at or above \$20), series proliferation concerns, and delisting because of low price, merger, takeover, or other events. In any event, with prior notice to the membership and customers, CBOE would continue to have the ability to cease trading series that become inactive and have no open interest.

¹⁵ If the underlying stock trades below \$20 after submission of the cessation notice by the Exchange, CBOE could list \$1 strike prices again provided it included the class as one of the five classes permitted under the Pilot Program.

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78(f)(5).