

not open for trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 2008(g), unless the current index value at expiration is fixed in accordance with the Rules and By-Laws of the Clearing Corporation; and

(ii) In the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading on that day, the price of that security, for the purposes of calculating the current index value at expiration, shall be the last reported sale price of the security.

The following A.M.-settled index options [that] are approved for trading on the Exchange: [shall be Specified (as provided in Rule 2000) in this subparagraph (a)(5).]

(i) *S&P SmallCap 600 Index.*

(b) Long-Term Index Options Series.

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(2) Reduced Value Long Term Options Series.

(i) Reduced-value long term options series [may be approved for trading on Specified (as provided in Rule 2000) indices.] *on the following stock indices are approved for trading on the Exchange:*

(A) *S&P SmallCap 600 Index.*

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(c) Procedures for Adding and Deleting Strike Prices. The procedures for adding and deleting strike prices for index options are provided in Rule 504, as amended by the following:

(1) The interval between strike prices will be no less than \$5.00; provided, that in the case of the following [the certain Specified (as provided in Rule 2000)] classes of index options, the interval between strike prices will be no less than \$2.50[.]:

(i) *S&P SmallCap 600 Index, if the strike price is less than \$200.00.*

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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 specified in Item III 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend its rules to provide for the listing and trading on the Exchange of cash-settled, European-style index options on the S&P SmallCap 600. Options on this index are currently trading on the Chicago Board Options Exchange ("CBOE").⁴ The proposed rule changes adopt the same standards that are currently applied for Index options traded on the CBOE.

a. Index Design.

The S&P SmallCap 600 Index is designed to measure the performance of small capitalization stocks. The Index is a capitalization-weighted index of U.S. stocks with each stock affecting the Index in proportion to its market capitalization.

As of August 21, 2003, the 600 component stocks ranged in capitalization from approximately \$3 billion to \$56 million, and the market capitalization of the Index totaled \$397 billion. The largest stock accounted for 0.74% of the total weighting of the Index, while the smallest accounted for 0.01%. The median capitalization of the components in the Index was \$517 million. A breakdown of the component stocks by trading markets shows that Nasdaq is the primary market for 43% of the weight of the Index (277 issues), the New York Stock Exchange ("NYSE") represents 56% (317 issues), and the American Stock Exchange ("AMEX") represents 1% (6 issues).

A total of 10 major industry sectors are represented in the Index. Those sectors and their weights are as follows: (1) Consumer Discretionary (20.2%); (2) Industrials (19.0%); (3) Information Technology (16.6%); (4) Financials (13.9%); (5) Health Care (12.9%); (6) Energy (5.4%); (7) Materials (4.4%); (8) Utilities (3.8%); (9) Consumer Staples (3.6%); and (10) Telecommunications Services (0.2%). During the period from March through August 2003, the average daily trading volume for the Index component stocks ranged from 8,468 to 4.3 million shares. As of September 25, 2003, a significant majority of the stocks are relatively actively traded, as indicated by an Index component median average daily trading volume of 139,002 shares. The top 100 stocks account for 34.14% of the Index, while

⁴ See Securities Exchange Act Release No. 35532 (March 24, 1995), 60 FR 16518 (March 30, 1995) (SR-CBOE-94-43) (Order approving the listing and trading of the S&P 600 on the CBOE).

the bottom 100 stocks account for 4.12% of the Index. The prices for each of the components ranged from \$2.10 to \$410.60. The average price was \$23.18. The shares outstanding for each of the Index component stocks ranged from approximately 4.96 million to 138.64 million with an average of 29.12 million.

S&P relies on several criteria to add or delete Index component stocks. Among other things, stocks must trade on the NYSE or Amex, or be Nasdaq NMS securities; stocks must have adequate liquidity and reasonable price evidenced by a 0.3 ratio of annual dollar value traded to market capitalization; the companies must have market capitalization between \$250 million and \$900 million; companies must have financial viability, measured as four consecutive quarters of positive as-reported earnings; companies must have public float of at least 40% of the stock; and companies must be operating companies, and not closed-end funds, holding companies, partnerships, investment vehicles or royalty trusts.⁵

b. Calculation.

The value of the Index is determined by Standard and Poor's by adding the price of each stock times the number of shares outstanding. This sum is then divided by an index divisor ("Index Divisor"), which gives the Index a value of 100 on its base date of December 31, 1993. The Index Divisor is adjusted by Standard & Poor's for pertinent changes in the component stocks. The Index had a closing value of 215.54 on May 31, 2003.

c. Maintenance.

The S&P Small Cap 600 is maintained by Standard and Poor's and ISE has represented that it will not influence any S&P decisions concerning the maintenance of the Index.⁶ To maintain continuity of the Index, Standard and Poor's adjusts the Index Divisor to reflect certain events relating to the component stocks. These events include, but are not limited to, adjustments for company additions and deletions, share changes, stock splits, stock dividends, and stock price adjustments due to company restructurings or spinoffs. Some corporate actions, such as stock splits and stock dividends, require simple

⁵ Should the character of the Index change from the basic description contained in the rule filing, ISE will so notify the Commission staff. Such a change could require filing a proposed rule change pursuant to section 19(b)(1) of the Act and Rule 19b-4 thereunder. See Amendment No. 1, *supra* note 3.

⁶ Telephone conference between Katherine Simmons, Vice President and Associate General Counsel, ISE, and Florence Harmon, Senior Special Counsel, Division, Commission, on October 1, 2003.