

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53805; File No. SR-CBOE-2006-31)

May 15, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Extend until June 5, 2007, a Pilot Program for Listing Options on Selected Stocks Trading Below \$20 at One-Point Intervals

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 27, 2006, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by CBOE. CBOE filed the proposal pursuant to Section 19(b)(3)(A) of the Act,³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to amend Commentary .01 to CBOE Rule 5.5, “Series of Option Contracts Open for Trading,” to extend until June 5, 2007, its pilot program for listing options series on selected stocks trading below \$20 at one-point intervals (“Pilot Program”). The text of the proposed rule change is available on CBOE’s Web site (<http://www.cboe.com>), at CBOE’s principal office, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

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

In its filing with the Commission, CBOE 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 IV below. CBOE 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 purpose of the proposed rule change is to extend the Pilot Program for an additional year ("Third Pilot Extension Notice").⁵ The Pilot Program allows CBOE to select a total of five individual stocks on which option series may be listed at \$1 strike price intervals.⁶ To be eligible

⁵ The Commission approved the Pilot Program on June 5, 2003. See Securities Exchange Act Release No. 47991 (June 5, 2003), 68 FR 35243 (June 12, 2003) (order approving File No. SR-CBOE-2001-60) ("Pilot Approval Order"). The Pilot Program was extended through June 5, 2005 and again through June 5, 2006. See Securities Exchange Act Release Nos. 49799 (June 3, 2004), 69 FR 32642 (June 10, 2004) (notice of filing and immediate effectiveness of File No. SR-CBOE-2004-34) ("First Pilot Extension Notice") and 51771 (May 31, 2005), 70 FR 33228 (June 7, 2005) (notice of filing and immediate effectiveness of File No. SR-CBOE-2005-37) ("Second Pilot Extension Notice") (collectively, "Pilot Extension Notices"). Under Interpretation and Policy .01(a) to CBOE Rule 5.5, the Pilot Program is scheduled to expire on June 5, 2006.

⁶ The Pilot Program generally allows CBOE to select a total of five individual stocks on which option series may be listed at \$1 strike price intervals. However, the Pilot Program was recently amended to provide that CBOE can designate no more than four individual stocks for inclusion in the Pilot Program at the same time there are strike prices listed for \$1 intervals on Mini-SPX options in accordance with Interpretation and Policy .14 to CBOE Rule 24.9. If CBOE were to determine to discontinue listing Mini-SPX option series at \$1 strike price intervals, CBOE would again be free to select up to five option classes for inclusion in the Pilot Program. See Securities Exchange Act Release No. 52625 (October 18, 2005), 70 FR 61479 (October 24, 2005) (File No. SR-CBOE-2005-81) (notice of filing and order granting accelerated approval of proposed rule change

for inclusion in the Pilot Program, the underlying stock must close below \$20 on its primary market on the previous trading day. If selected for the Pilot Program, the Exchange may list strike prices at \$1 intervals from \$3 to \$20, but no \$1 strike price may be listed that is greater than \$5 away from the underlying stock's closing price on its primary market on the previous day. The Exchange also may list \$1 strikes on any other options class designated by another options exchange that employs a similar pilot program under its rules. Under the terms of the Pilot Program, the Exchange may not list long-term option series ("LEAPS"®) at \$1 strike price intervals for any class selected for the Pilot Program. The Exchange also is restricted from listing any series that would result in strike prices being \$0.50 apart.

As stated in its previous filings establishing and extending the Pilot Program,⁷ CBOE believes that \$1 strike price intervals provide investors with greater flexibility in the trading of equity options that overlie lower-priced stocks⁸ by allowing investors to establish equity options positions that are better tailored to meet their investment objectives.⁹ As reflected in the First Pilot Extension Notice, the trading volume in a wide majority of the classes selected for the Pilot Program increased significantly within the first year after being selected for the Pilot Program.¹⁰ In ten of the 22 classes originally selected, average daily trading volume ("ADV") increased over 100%, and in some classes ADV more than tripled.¹¹ As reflected in the Second Pilot Extension Notice, after almost two years since the inception of the Pilot Program, ADV in several options

relating to options on a reduced-value version of the Standard and Poor's 500 Stock Index ("Mini-SPX options").

⁷ See Pilot Approval Order and Pilot Extension Notices, supra note 5.

⁸ To be eligible for inclusion in the Pilot Program, the underlying stock must close below \$20 per share on its primary market on the previous trading day.

⁹ See Pilot Approval Order and Pilot Extension Notices, supra note 5.

¹⁰ See First Pilot Extension Notice, supra note 5.

¹¹ See First Pilot Extension Notice, supra note 5.

classes remained significantly higher than immediately prior to their respective selection in the Pilot Program.¹² Now, almost three years since the inception of the Pilot Program, CBOE notes that ADV in several options classes remains significantly higher than immediately prior to their selection for the Pilot Program.¹³ It should be noted that, as reflected in the Pilot Program Report for the Second Pilot Extension Notice and this Third Pilot Extension Notice, ADV also has dropped in several options classes since their selection for the Pilot Program, although it is difficult to identify the specific market factors that may contribute to the increase or decrease in options trading volume from one particular class to another, especially considering the time removed since the inception of the Pilot Program. However, the Exchange still believes that the practice of offering customers strike prices for lower-priced stocks at \$1 intervals contributes to the overall volume of the participating options classes.

With regard to the impact on system capacity, CBOE's analysis of the Pilot Program also suggests that the impact on CBOE's, the Options Price Reporting Authority's ("OPRA"), and market data vendors' respective automated systems has been minimal. Specifically, CBOE notes that in February 2006, 22 of the 23 classes participating in the Pilot Program accounted for 7,002,356 quotes per day or 0.89% of the industry's 790,899,315 average quotes per day.¹⁴ The 23 classes averaged 268,468 contracts per day or 3.56% of the industry's 7,531,756 average

¹² See Second Pilot Extension Notice, supra note 5.

¹³ Pursuant to the Pilot Extension Notices, CBOE is submitting a report (the "Pilot Program Report"), as Exhibit 3 to the proposal. Among other things, the Pilot Program Report contains analyses of the ADV and open interest ("OI") for the options classes that have been selected for the Pilot Program since its inception.

¹⁴ Quoting information is not included for CPN, which was delisted from the New York Stock Exchange on December 6, 2005 and trading in the existing option series was restricted.

contracts per day. The classes involved totaled 1458 series or 1.1% of all series listed.¹⁵ It should be noted that these quoting statistics may overstate the contribution of \$1 strike prices because these figures also include quotes for series listed in intervals higher than \$1 (i.e., \$2.50 strikes) in the same options classes. Even with the non-\$1 strike series quoting being included in these figures, CBOE believes that the overall impact on capacity is still minimal.

2. Statutory Basis

The Exchange believes that an extension of the Pilot Program is warranted because the data indicates that there is strong investor demand for \$1 strikes and because the Pilot Program has not adversely impacted systems capacity. For these reasons, the Exchange believes the proposed rule change is consistent with the Act and the rules and regulations under the Act 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 requirements of Section 6(b)(5)¹⁷ that the rules of a national securities 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

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

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

The Exchange neither solicited nor received comments on the proposal.

¹⁵ See Pilot Program Report, infra Exhibit 3.

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78f(b)(5).

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

CBOE has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act¹⁸ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁹ Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder. As required under Rule 19b-4(f)(6)(iii), CBOE provided the Commission with written notice of its intention to file the proposed rule change at least five business days prior to filing the proposal with the Commission or such shorter period as designated by the Commission.²⁰

¹⁸ 15 U.S.C. 78s(b)(3)(A).

¹⁹ 17 CFR 240.19b-4(f)(6).

²⁰ As set forth in the Commission's initial approval of the Pilot Program, if CBOE proposes to: (1) extend the Pilot Program; (2) expand the number of options eligible for inclusion in the Pilot Program; or (3) seek permanent approval of the Pilot Program, it must submit a Pilot Program report to the Commission along with the filing of its proposal to extend, expand, or seek permanent approval of the Pilot Program. CBOE must file any such proposal and the Pilot Program report with the Commission at least 60 days prior to the expiration of the Pilot Program. The Pilot Program report must cover the entire time the Pilot Program was in effect and must include: (1) data and written analysis on the open interest and trading volume for options (at all strike price intervals) selected for the Pilot Program; (2) delisted options series (for all strike price intervals) for all options selected for the Pilot Program; (3) an assessment of the appropriateness of \$1 strike price intervals for the options CBOE selected for the Pilot Program; (4) an assessment of the impact of the Pilot Program on the capacity of CBOE's, OPRA's, and vendors' automated systems; (5) any capacity problems or other problems that arose during the operation of the Pilot Program and how CBOE addressed them; (6) any complaints that CBOE received during the operation of the Pilot Program and how CBOE addressed them; and (7) any additional information that would help to assess the operation of the Pilot Program. See Pilot Approval Order, supra note 5.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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 No. SR- CBOE-2006-31 on the subject line.

Paper comments:

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

All submissions should refer to File No. SR- CBOE-2006-31. 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. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR- CBOE-2006-31 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²¹

Nancy M. Morris
Secretary

²¹ 17 CFR 200.30-3(a)(12).