

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55673; File No. SR-CBOE-2007-38)

April 26, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Extension of a Pilot Program That Allows for the Listing of Option Series at \$1 Strike Price 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 24, 2007, 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 substantially prepared by CBOE. The Exchange has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders it 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

The Exchange proposes to extend the pilot period for the \$1 strike price pilot program (“Pilot Program”) for an additional year until June 5, 2008. The text of the proposed rule change is available at CBOE, the Commission’s Public Reference Room, and www.cboe.org/legal.

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 (“Fourth 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 In order to be eligible for selection into the Pilot Program, the underlying stock must close below \$20 on its

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) (SR-CBOE-2001-60) (“Pilot Approval Order”). The Pilot Program been subsequently extended through June 5, 2007. See Securities Exchange Act Release Nos. 49799 (June 3, 2004), 69 FR 32642 (June 10, 2004) (SR-CBOE-2004-34) (“First Pilot Extension Notice”); 51771 (May 31, 2005), 70 FR 33228 (June 7, 2005) (SR-CBOE-2005-37) (“Second Pilot Extension Notice”); and 53805 (May 15, 2007), 71 FR 29690 (May 23, 2006) (SR-CBOE-2006-31) (“Third Pilot Extension Notice”) (collectively, “Pilot Extension Notices”).

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 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) (SR-CBOE-2005-81) (notice of filing and order granting accelerated approval of proposed rule change relating to options on a reduced-value version of the Standard and Poor’s 500 Stock Index).

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 from the underlying stock's closing price in its primary market on the previous day. The Exchange also may list \$1 strikes on any other options class designated by another securities 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 and in ten of the 22 classes originally selected, average daily trading volume ("ADV") increased over 100%, and in some classes ADV more than tripled.¹⁰ Now, almost four years since the inception of the Pilot Program, CBOE notes that ADV in several options classes continues to remain significantly higher than immediately prior to their respective selection in the Pilot Program.¹¹ It

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

⁸ In order 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 Pursuant to the Pilot Extension Notices, CBOE is submitting a report ("Pilot Program Report"), as Exhibit 3 to the proposal. Among other things, the Pilot Program Report

should be noted that, as reflected in the Pilot Program Report for this Fourth Pilot Extension Notice, ADV has also 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 March 2007, 21 classes participating in the Pilot Program accounted for 12,950,404 average quotes per day or 1.20% of the industry's 337,744,725 average quotes per day. The 21 classes averaged 412,007 contracts per day or 3.96% of the industry's 10,412,091 average contracts per day. The 21 classes involved totaled 2754 series or 1.80% of all series listed.¹² 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.

contains analyses of the ADV and open interest for the options classes that have been selected for the Pilot Program since its inception.

¹² See Pilot Program Report attached as Exhibit 3 to CBOE's proposed rule change.

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.¹³ Specifically, the Exchange believes the proposed rule change is consistent with the requirements of Section 6(b)(5)¹⁴ 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 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 proposal.

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

Because the foregoing rule change does not: (1) significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days from the date of this filing, or such shorter time as the Commission

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁵ and Rule 19b-4(f)(6) thereunder.¹⁶

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:

¹⁵ 15 U.S.C. 78s(b)(3)(A).

¹⁶ 17 CFR 240.19b-4(f)(6). Rule 19b-4(f)(6) also requires the self-regulatory organization to give the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. CBOE has satisfied the five-day pre-filing requirement. 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 proposal to expand or seek permanent approval of the Pilot Program 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.

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-2007-38 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-2007-38. 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-2007-38 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.¹⁷

Florence E. Harmon
Deputy Secretary

¹⁷ 17 CFR 200.30-3(a)(12).