

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51771; File No. SR-CBOE-2005-37)

May 31, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Extend until June 5, 2006, 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 May 9, 2005, 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 and II below, which Items have been prepared by the CBOE. The 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.⁵ 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 CBOE proposes to amend Commentary .01 to CBOE Rule 5.5, "Series of Option Contracts Open for Trading," to extend until June 5, 2006, 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 the CBOE’s Web site (<http://www.cboe.com>), at the 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).

⁵ The CBOE has asked the Commission to waive the 30-day operative delay. See Rule 19b-4(f)(6)(iii), 17 CFR 240.19b-4(f)(6)(iii).

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 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. The 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.⁶ The Pilot Program allows the CBOE to select a total of five individual stocks on which option series may be listed at \$1 strike price intervals. To be eligible 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

⁶ 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 for an additional year on June 3, 2004. See Securities Exchange Act Release No. 49799 (June 3, 2004), 69 FR 32642 (June 10, 2004) (notice of filing and immediate effectiveness of File No. SR-CBOE-2004-34) ("Pilot Extension Notice"). Under Interpretation and Policy .01(a) to CBOE Rule 5.5, the Pilot Program is scheduled to expire on June 5, 2005.

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 the 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 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 Now, almost two years since the inception of the Pilot Program, the CBOE notes that ADV in several options classes remains significantly higher than immediately prior to their selection for the Pilot Program.¹² It should be noted that, as reflected in the Pilot Program Report, 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

⁷ See Pilot Approval Order and Pilot Extension Notice, supra note 6.

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 Notice, supra note 6.

¹⁰ See Pilot Extension Notice, supra note 6.

¹¹ See Pilot Extension Notice, supra note 6.

¹² Pursuant to the Pilot Extension Notice, the 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.

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, the CBOE's analysis of the Pilot Program also suggests that the impact on the CBOE's, the Options Price Reporting Authority's ("OPRA"), and market data vendors' respective automated systems has been minimal. Specifically, the CBOE notes that in February 2005, the 21 classes participating in the Pilot Program accounted for 8,482,369 quotes per day or 2.26% of the industry's 374,547,949 average quotes per day. These 21 classes averaged 285,509 contracts per day or 5.11% of the industry's 5,589,841 average contracts per day. The classes involved totaled 881 series or 2.47% of all series listed.¹³ 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, the 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.¹⁴ Specifically, the Exchange believes the proposed rule change is consistent with the

¹³ See Pilot Program Report, infra Exhibit 3.

¹⁴ 15 U.S.C. 78f(b).

requirements of Section 6(b)(5)¹⁵ 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

The 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

No written comments were solicited or received.

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

The CBOE has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act¹⁶ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁷ 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), the 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.

¹⁵ 15 U.S.C. 78f(b)(5).

¹⁶ 15 U.S.C. 78s(b)(3)(A).

¹⁷ 17 CFR 240.19b-4(f)(6).

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative for 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The CBOE has asked the Commission to waive the 30-day operative delay to permit the Pilot Program extension to become effective at the time the Commission waives the 30-day operative delay.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because it will allow the Pilot Program to continue without interruption through June 5, 2006.¹⁸ For this reason, the Commission designates that the proposal become operative on June 5, 2005.¹⁹

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

¹⁸ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁹ As set forth in the Commission's initial approval of the Pilot Program, if the 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. The 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 the CBOE selected for the Pilot Program; (4) an assessment of the impact of the Pilot Program on the capacity of the 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 the CBOE addressed them; (6) any complaints that the CBOE received during the operation of the Pilot Program and how the 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 6.

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-2005-37 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File No. SR- CBOE-2005-37. 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing will also be available for inspection

and copying at the principal office of the 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-2005-37 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.²⁰

Margaret H. McFarland
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).