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 self-regulatory organization 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 self-regulatory organization 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

The CBOE believes the purchase of a BOUND will be substantially equivalent to a "buy-write" transaction (*i.e.*, the simultaneous writing of a call option and purchase of the underlying stock). Unlike an actual buy-write transaction, however, the purchase of a BOUND is effected in a single exchange transaction. The Options Clearing Corporation ("OCC") will be the issuer of all BOUNDs traded on the Exchange.

As with OCC issued options, BOUNDs will be created when an opening buy and an opening sell order are executed. The execution of every such order will increase BOUNDs open interest. Except as described herein, BOUNDs will be subject to the rules governing standardized options.

A BOUND holder will be in essentially the same economic position as a covered call writer except that a BOUND is not subject to exercise before expiration. BOUND holders will profit from the stock's movement up to the strike price and will receive payments equivalent to the cash dividends paid on the underlying stocks. On the ex-date for a stock dividend, OCC will debit all short BOUND accounts and credit all long BOUND accounts with an amount equal to the dividend on the underlying stock.

Like put and call options, BOUNDS will trade in standardized contract units of 100 shares of underlying stock per BOUND contract. At expiration, BOUND holders will receive 100 shares of the underlying stock for each BOUND contract held if on the last day of trading, the underlying stock closes at or below the strike price. However, if at expiration the underlying stock closes above the strike price, the BOUND holder will receive a payment equal to 100 times the BOUND's strike price for each BOUND contract held. Persons who have sold BOUND contracts will be required to deliver either 100 shares of the underlying stock for each BOUND contract or the strike price multiplied by 100 at expiration, depending on the price of the underlying stock at that time. This is the same economic result that accrues to a covered call writer who holds the position to the expiration of the call option.

For example, if the XYZ BOUND has a strike price of \$50 and XYZ stock closes at \$50 or less at expiration, the holder of an XYZ BOUND contract will receive 100 shares of XYZ stock. This is the same result as if the call option in a buy-write position had expired out of the money; i.e., the option would expire worthless and the writer would retain the underlying stock. If XYZ closes above \$50 per share, then the holder of an XYZ BOUND contract will receive \$5,000 in cash (100 times the \$50 strike price). This mimics the economic result to the covered call writer when the call is in the money at expiration and is exercised, i.e., the writer would receive an amount equal to 100 shares times the strike price and, because he would be required to deliver the stock, would forfeit any appreciation above that price.

The criteria for stocks underlying BOUNDs will be the same as the criteria for stocks underlying stock options. The Exchange anticipates that it will list BOUNDs on the same underlying securities on which Long-Term Equity Option Series ("LEAPs") are listed. BOUNDs will be listed at the same strike prices and expiration dates as their respective LEAPs except that BOUNDs will be listed only at strike prices that are at (or very near) or below the then current price of the underlying stock. BOUNDs will be listed with up to 39 months until expiration.

It is anticipated that the sum of the market prices of a LEAP and a BOUND on the same underlying stock with the same expiration date and exercise price will approximate the market price of the underlying stock. If the combined price of the LEAP and BOUND diverge from that of the underlying stock, it is anticipated that arbitrage activity will tend to bring the price relationships back into line.

There is also a relationship between the settlement at expiration of a LEAP and a BOUND having the same underlying security, strike price and expiration date. If at expiration the underlying stock closes at or below the strike price, the LEAP call will expire worthless, and the holder of a BOUND contract will receive 100 shares of stock from the seller of a BOUND position. if, on the other hand, the LEAP call is in the money at expiration, the holder of the LEAP call is entitled to 100 shares of stock from a short LEAP upon payment of the strike price, and the holder of a BOUND contract is entitled to the strike price times 100 in cash from the short BOUND. While it seems unlikely that an investor would be long both a LEAP and a BOUND at expiration, it is illustrative to consider how such a position would be settled. To continue with the above example where XYZ closes above the \$50 strike price at expiration, an investor long both a LEAP and a BOUND contract would be entitled to receive \$5,000 in cash from the short BOUND and, upon exercise of the LEAP, would be obligated to pay \$5,000 to receive 100 shares of XYZ stock.

The settlement of the LEAP and BOUND at expiration are equally well harmonized from the perspective of the writer. For example, if a writer of both instruments is covered with the underlying stock and the stock closes above the strike price, at expiration, the writer delivers the stock to the long LEAP call and receives in return payment of the strike price times 100, which amount is then delivered to the long BOUND. A covered writer's position, therefore, effectively is closed upon the delivery of the covering stock. If a writer of both instruments has deposited cash or securities other than the underlying stock as margin for a short LEAP call and BOUND, then the writer delivers 100 shares of stock (purchased on the open market) to the long LEAP call upon payment of the strike price times 100. The writer of the BOUND then delivers 100 times the strike price to the holder of the long BOUND.

It should be noted that LEAPs are American-style options whereas BOUNDs are European-style in that they cannot be "exercised" prior to expiration.¹ The Exchange believes that a European-style BOUND will have greater acceptance among investors than an American-style product since a European-style BOUND will permit purchasers to enjoy the enhanced yield that the BOUND provides for a certain period of time. Furthermore, because some type of performance-either delivery of the underlying stock or payment of the strike price-is always required at expiration, the CBOE believes that notice of exercise is not necessary and, therefore, will not be required.

¹ A European-style option may only be exercised during a limited period of time before the option expires. An American-style option may be exercised at any time prior to its expiration.