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 PSE, pursuant to Rule 19b–4 under the Act, proposes to amend its rules to permit trading in Buy-Write Options Unitary Derivatives ("BOUNDs").¹ As described in more detail below, BOUNDs are long term options which the PSE believes have the same economic characteristics as a covered call writing strategy.

The text of the proposed rule change is available at the Office of the Secretary, PSE and at the Commission.

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 statutory 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 section (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 Exchange is proposing to list for trading BOUNDs. The Options Clearing Corporation ("OCC") will be the issuer of all BOUNDs traded on the Exchange. As with all OCC issued options, BOUNDs will be created when an opening buy and an opening sell order are executed. The execution of such orders will increase the open interest in BOUNDs. Except as described herein, BOUNDs will be subject to the rules governing standardized options.

The Exchange anticipates listing BOUNDs with respect to those underlying securities that have listed LEAPs. The criteria for stocks underlying BOUNDs will be the same as the criteria for stocks underlying LEAPs.

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 and exercise price will closely approximate the market price for the underlying stock. If the combined

price of the LEAP and BOUND diverge from that of the underlying common stock, there will be an arbitrage opportunity which, when executed, should bring the price relationships back into line.

BOUNDs will have the same strike prices and expiration dates as their respective LEAPs except that the Exchange will list only a strike price that is at or very close to the price of the underlying stock at the time of listing, or that is below the price of the stock at that time. For example, at the time of initial listing, the strike prices for a BOUND with the underlying stock trading at \$50 per share, would be set at \$40 and \$50. The Exchange would not list a BOUND with a strike price of \$60 in this example.

The Exchange anticipates that it will list new complementary LEAPs and BOUNDs on the same underlying securities annually, or at more frequent intervals, depending on market demand. The Exchange has the current authority to list LEAPs with up to 39 months until expiration and, therefore, seeks to introduce BOUNDs with up to the same 39 month duration.

BOUNDs will offer essentially the same economic characteristics as covered calls with the added benefits that BOUNDs can be traded in a single transaction and are not subject to early exercise. BOUND holders will profit from appreciation in the underlying stock's price up to the strike price and will receive payments equivalent to any cash dividends declared on the underlying stock. On the ex-dividend date for the underlying stock, OCC will debit all accounts with short positions in BOUNDs and credit all accounts with long positions in BOUNDs with an amount equal to the cash dividend on the underlying stock.

Like regular options, BOUNDs will trade in standardized contract units of 100 shares of underlying stock per BOUND so that 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 contract holder will receive a payment equal to 100 times the BOUND's strike price for each BOUND contract held. BOUND writers 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 settlement design is similar to the economic result that accrues to an

investor who has purchased a covered call (*i.e.*, long stock, short call) and held that 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 the 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 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 expires in the money, i.e., the writer would receive an amount equal to 100 shares times the strike price and would forfeit any appreciation above that price.

The settlement mechanism for the BOUNDs will operate in conjunction with that of LEAP calls. For example, 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 short BOUND. 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 cash equivalent of the strike price times 100 from the short BOUND. An investor long both a LEAP and a BOUND, where XYZ closes above the \$50 strike price at expiration, 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 Exchange believes the settlement of the LEAP and BOUND at expiration are equally well harmonized from the perspective of the writer. For example, an investor long the underlying stock, and who writes both a LEAP and a BOUND, will be obligated to deliver the stock to the long LEAP call if the underlying stock closes above the strike price, and will receive in return payment of the strike price times 100, which amount will then be delivered to the long BOUND. Accordingly, the Exchange believes a covered writer's position is effectively closed upon the delivery of the underlying 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

 $^{^{\}rm 1}$ The PSE notes that BOUNDs is a service mark of The American Stock Exchange, Inc.