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 purpose of the proposed rule change is to permit the Exchange to list and trade cash-settled, European-style stock index options on the S&P SmallCap 600. The S&P SmallCap 600 is a capitalization-weighted index of 600 domestic stocks chosen for market size, liquidity, and industry group representation.

(1) Index Design

the S&P SmallCap 600 Index has been designed to measure the performance of small capitalization stocks. The Index is a capitalization-weighted index of U.S. stocks with each stock affecting the Index in proportion to its market capitalization.

As of October 19, 1994, the 600 component stocks ranged in capitalization from \$933 million to \$46 million, and the market capitalization of the Index totalled \$181 billion. The largest stock accounted for 0.51% of the total weighting of the Index, while the smallest accounted for 0.03%. The median capitalization of the firms in the index was \$267 million. A breakdown of the stocks by trading markets shows that Nasdaq represents 53% of the Index (318 issues), the New York Stock Exchange represents 43% (257 issues), and the American Stock Exchange represents 4% (25 issues). The Nasdaq stocks in the Index are authorized as Nasdag National Market securities, the top tier of Nasdaq stocks.

A total of 98 industry groups are represented in the Index. The top five groups and their weights are: (1) Computer Software and Services— 9.01%; (2) Insurance—5.13%; (3) Savings and Loans—4.88%; (4) Health Care Services—4.31%; and (5) Banks— Regional—4.26%. During the period April through September 1994, the average monthly volume for the 600 stocks ranged from 93,000 to 25.3 million shares. The average monthly volume was 1.9 million shares. The top 100 stocks account for 33.42% of the index, while the bottom 100 stocks account for 5.69% of the Index. The prices for each of the components ranged from \$1.375 to \$64.5. The average price was \$19.37. The shares outstanding for each of the stocks ranged from 4.0 million to 189.0 million with an average of 17.8 million.³

S&P relies on several criteria to select Index component stocks. Among other things, stocks must trade on the New York Stock Exchange, American Stock Exchange, or be Nasdaq National Market securities; stocks must trade above \$1.00 at the time of selection; companies with 50% or more of their shares outstanding held by another corporation are not included; companies with 60% or more of their shares held by insiders are not included: stocks must have at least a six month trading history; stocks that do not trade on any three days during a 12month period are not included; and share turnover (annual trading volume as a percent of shares outstanding) has to exceed 20% on an annualized basis. Index component stocks are then chosen from the field of stocks that meets these criteria so that they balance the economic sector weightings, described above.4

(2) Calculation

The methodology used to calculate the value of the Index is similar to that used to calculate the value of the S&P 500 Index. The value of the Index is determined by adding the price of each stock times the number of shares outstanding. This sum is then divided by an index divisor ("Index Divisor") which gives the Index a value of 100 on its base date of December 31, 1993. The Index Divisor is adjusted for pertinent changes as described below in the section titled "Maintenance." The Index has a closing value of 96.82 on September 30, 1994.

(3) Maintenance

The S&P SmallCap 600 will be maintained by S&P. To maintain continuity of the Index, the Index Divisor will be adjusted to reflect certain events relating to the component stocks. These events include, but are not limited to, adjustments for company additions and deletions, share changes, stock splits, stock dividends, and stock price adjustments due to company restructurings or spinoffs. Some corporate actions, such as stock splits and stock dividends, require simple changes in the common shares outstanding and the stock prices of the companies in the Index. Other corporate actions, such as share issuances, change the market value of the Index and require an Index Divisor adjustment as well.

(4) Index Option Trading

In addition to regular Index options, the Exchange may provide for the listing of long-term (up to three years expiration) index options series ("LEAPS") and reduced-value LEAPS on the Index. For reduced-value LEAPS, the underlying value would be computed at one-tenth of the Index level. The current and closing index value of any such reduced-value LEAP will, after such initial computation, be rounded to the nearest one-hundredth.

The Exchange seeks to have the discretion to list series in $2\frac{1}{2}$ point intervals when the Index level falls below 200. The minimum tick size for series trading below \$3 will be $\frac{1}{16}$ and for series trading above \$3 the minimum tick will be $\frac{1}{8}$ th. The trading hours for options on the Index will be from 8:30 a.m. to 3:15 p.m. Chicago time.

(5) Exercise and Settlement

The proposed options on the Index will expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 3:15 p.m. (Chicago time) on the immediately preceding Thursday.⁵ The Index multiplier will be 100. The exercise settlement value of the Index at option expiration will be calculated by S&P based on the opening prices of the component securities on the business day prior to expiration ("A.M. Settlement"). If a stock fails to open for trading, the last available price on the stock will be used in the calculation of the index, as is done for currently listed indexes.

(6) Surveillance

The Exchange will use the same surveillance procedures currently used for each of the Exchange's other index options to monitor trading in Index options and Index LEAPS on the S&P SmallCap 600. For surveillance purposes, the Exchange will have complete access to information

³See Amendment No. 1, *supra* note 2. ⁴*Id.*

⁵ When the last trading day is moved because of Exchange holidays (such as when CBOE is closed on the Friday before expiration), the last trading day for expiring options will be Wednesday and the exercise settlement value of Index options at expiration will be determined at the opening of regular Thursday trading.