SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-49418; File No. SR-PCX-2004-18)

March 15, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Bid-Ask Differentials

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 March 11, 2004, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the PCX. The PCX filed the proposal pursuant to Section 19(b)(3)(A) under 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 PCX proposes to amend PCX Rule 6.37, "Obligations of Market Makers," to permit the Options Floor Trading Committee ("OFTC") to establish, with respect to options trading with a bid price of less than $2, bid-ask differentials that are no more than $0.50 wide ("double-width") when the primary market for the underlying security: (1) reports a trade outside of its disseminated quote (including any Liquidity Quote); or (2) disseminates an inverted quote. The double-width relief must terminate automatically when the condition that necessitated the

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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 PCX 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).

double-width relief is no longer present. The text of the proposed rule change appears below. Additions are italicized.[6]

Obligations of Market Makers

Rule 6.37(a) – No change.

Rule 6.37(b)(1)(A) – (E) – No change.

(F) The OFTC may, with respect to options trading with a bid price less than $2, establish bid-ask differentials that are no more than $0.50 wide ("double-width") when the primary market for the underlying security: (a) Reports a trade outside of its disseminated quote (including any Liquidity Quote); or (b) disseminates an inverted quote. The imposition of double-width relief must automatically terminate when the condition that necessitated the double-width relief (i.e., condition (a) or (b)) is no longer present. Market makers that have not automated this process may not avail themselves of the relief provided herein (i.e. they may not manually adjust prices.)

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 PCX 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 PCX 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

[6] The PCX indicated that the proposed rule should be paragraph (F) of PCX Rule 6.37(b)(1). See e-mail message from Steven B. Matlin, Senior Attorney, Regulatory Policy, PCX, to Yvonne Fraticelli, Special Counsel, Division of Market Regulation, Commission, dated March 12, 2004.

for, the Proposed Rule Change

1. Purpose

PCX Rule 6.37 sets forth the obligation of market makers and establishes bid-ask differentials. The PCX proposes to amend PCX Rule 6.37 to codify two instances when the bid-ask differential for options trading with a bid price of less than $2 may be wider than the $0.25 interval expressly required for such options in PCX Rule 6.37(b)(1)(A). Specifically, with respect to options trading with a bid price of less than $2, the proposal would authorize the OFTC to establish bid-ask differentials that are no more than $0.50 wide when the primary market for the underlying security: (1) reports a trade outside of its disseminated quote (including any Liquidity Quote); or (2) disseminates an inverted quote.[7] The proposed quote width relief will apply to options on stocks and options on exchange-traded funds ("ETFs").

The proposed quote width relief will apply only to options that trade with a bid price of less than $2. Thus, options trading at a price of $2 (bid) or higher will not be eligible for the proposed quote width relief. The PCX notes that options trading at less than $2 are subject to a $0.25 bid-ask differential, which generally means that market makers have only $0.125 of pricing latitude on either side of the theoretical value to widen their quotes to take into account any pricing discrepancy in the underlying security.

Under the proposal, PCX market makers will not be permitted to widen their quotes when the New York Stock Exchange, Inc. ("NYSE") prints a trade at or within its Liquidity Quote. Because the NYSE disseminates Liquidity Quotes, which are quotes of substantial size outside of

[7] The proposed rule is based on Chicago Board Options Exchange, Inc. ("CBOE") Rule 8.7(b)(iv). See Securities Exchange Act Release No. 48990 (December 23, 2003), 68 FR 75673 (December 31, 2003) (File No. SR-CBOE-2003-25) (order approving CBOE Rule 8.7(b)(iv)) ("CBOE Approval Order").

the regular disseminated quote, the PCX notes that PCX market makers should not be surprised if the NYSE prints a trade outside of its regular quote but at or within its Liquidity Quote. For this reason, the PCX does not propose to allow the OFTC to authorize PCX market makers to widen their quotes when the NYSE prints a trade at or within the Liquidity Quote. However, if the NYSE prints a trade outside of the Liquidity Quote, a PCX market maker would be able to widen its quotes.

A PCX market maker will be eligible for the proposed relief only if the market maker has an automated quotation system that returns the market maker's quotes to normal width upon the termination of the triggering event. Double-width relief will not be available to market makers who must rely on manual input to restore quote values to normal width. Automation of this process ensures that double-width relief will take effect only when permissible and, more importantly, will last only as long as the condition that necessitated it occurs.[8] Thus, there will be no sustained dissemination of stale double-wide quotes when one of the triggering events is not present.

2. Statutory Basis

The PCX believes that the proposal is consistent with Section 6(b) of the Act,[9] in general, and Section 6(b)(5) of the Act,[10] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing

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[8] Thus, to be eligible for the proposed double-wide relief, a market maker must automate this process in his or her own proprietary trading software. Market makers who do not automate this process will not be eligible for the proposed relief. At this time, the PCX will not be making the necessary software changes to the POETS system to automate this process.

[9] 15 U.S.C. 78f(b).

[10] 15 U.S.C. 78f(b)(5).

information with respect to, and facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

B. Self-Regulatory Organization's Statement on Burden on Competition

The PCX does not believe that the proposed rule change will impose any burden on competition that is 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 PCX neither solicited nor received written comments on the proposed rule change.

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

The PCX has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act[11] and subparagraph (f)(6) of Rule 19b-4 thereunder.[12] 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) does not become operative for 30 days from the date of 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 PCX provided the Commission with written notice of its intent 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.

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[11] 15 U.S.C. 78s(b)(3)(A).

[12] 17 CFR 240.19b-4(f)(6).

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 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 PCX has requested that the Commission waive the 30-day operative delay specified in Rule 19b-4(f)(6) because the PCX's proposal provides quote width relief similar to that provided under the rules of the CBOE. Accordingly, the PCX believes that its proposal does not raise new regulatory issues, significantly affect the protection of investors or the public interest, or impose any significant burden on competition.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the proposed rule change is substantially similar to a rule adopted previously by the CBOE.[13] The CBOE's proposed rule was published for comment and the Commission received no comments regarding the CBOE's proposal. The Commission believes that the PCX's proposal raises no new issues or regulatory concerns that the Commission did not consider in approving the CBOE's proposal. For this reason, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, and the Commission designates the proposal to be operative upon filing with the Commission.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is

[13] See CBOE Rule 8.7(b)(iv) and CBOE Approval Order, supra note 7. 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).

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 it is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-PCX-2004-18. The 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-2004-18 and should be submitted by [insert date 21 days after the date of this publication].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[14]

Jill M. Peterson
Assistant Secretary

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[14] 17 CFR 200.30-3(a)(12).