

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 Number SR-BSE-2004-22 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 Number SR-BSE-2004-22. 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 also will be available for inspection and copying at the principal office of BSE. 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 Number SR-BSE-2004-22 and should be submitted on or before July 1, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49799; File No. SR-CBOE-2004-34]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. to Extend a Pilot Program Under Which it Lists Options on Selected Stocks Trading Below \$20 at One-Point Intervals Until June 5, 2005

June 3, 2004.

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 24, 2004, the Chicago Board Options Exchange, Inc. ("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 CBOE. CBOE filed Amendment No. 1 the proposal on May 28, 2004.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to extend its pilot program under which it lists options on selected stocks trading below \$20 at \$1 strike price intervals ("Pilot Program") until June 5, 2005. The text of the proposed rule change is available at the Office of the Secretary, CBOE, and 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, 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. 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

CBOE proposes to extend the Pilot Program for an additional year until June 5, 2005.⁴ The current Pilot Program allows CBOE to select a total of 5 individual stocks on which option series may be listed at \$1 strike price intervals. To be eligible for selection into the Pilot Program, the underlying stock must close below \$20 in its primary market on the previous trading day. If selected for the Pilot Program, CBOE may list strike prices at \$1 intervals from \$3 to \$20, but no \$1 strike price may be listed that is greater than \$5 from the underlying stock's closing price in its primary market on the previous day. CBOE also may list \$1 strikes on any other option class designated by another securities exchange that employs a similar Pilot Program under their respective rules. CBOE cannot list long-term option series ("LEAPS"®) at \$1 strike price intervals for any class selected for the Pilot Program. CBOE also is restricted from listing any series that would result in strike prices being \$0.50 apart.

CBOE believes that listing of one point strike price intervals in selected equity options provides investors with more flexibility in the trading of equity options overlying stocks trading at less than \$20 by allowing investors to establish equity options positions that are better tailored to meet their investment objectives. CBOE has conducted a study into the impact that \$1 strikes has made on the participating Pilot Program classes ("Pilot Program Report").⁵ Specifically, in the Pilot Program Report, CBOE compared the average daily trading volume ("ADV") for the three month period immediately preceding the listing of \$1 strikes to the most recent three month period (ending March 31, 2004) for each of the classes selected to the Pilot Program to date. According to CBOE's Pilot Program Report, the trading volume in a wide majority of the classes selected to the Pilot Program has increased. In ten of the twenty-two classes selected since the inception of the program, the ADV has increased over 100%, while in some

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from James M. Flynn, Attorney II, Legal Division, CBOE, to Christopher Solgan, Attorney, Division, Commission, dated May 26, 2004 ("Amendment No. 1"). In Amendment No. 1, CBOE changed the file number of the proposed rule change from SR-CBOE-2004-32 to SR-CBOE-2004-34.

⁴ 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). Under Interpretation and Policy .01(a) to CBOE Rule 5.5, the Pilot Program is scheduled to expire on June 5, 2004.

⁵ CBOE attached the Pilot Program Report as an exhibit to this proposed rule change. Copies of the Pilot Program Report are available at CBOE and the Commission's Public Reference Room.

¹² 17 CFR 200.30-3(a)(12).

classes, the ADV has more than tripled since the respective selection date. The Pilot Program Report also suggests that the impact on CBOE's, the Options Price Reporting Authority's ("OPRA"), and market data vendors' respective automated systems has been minimal. Specifically, in May 2003, activity in the 22 Pilot classes represented 2.01% of all OPRA quotes and 3.22% of all OPRA series being quoted. In March 2004, those same classes represented 3.00% of all quotes and 3.31% of all series being quoted. In addition to \$1 strikes, CBOE believes that other factors may have an impact on capacity, including the implementation of CBOE's Hybrid trading system and quoting in strike prices other than \$1 strike price intervals.

2. Statutory Basis

According to CBOE, an extension of the Pilot Program is warranted because it believes the data provided in its Pilot Program Report indicates that there is strong investor demand for \$1 strikes and that the Pilot Program has not adversely impacted capacity. For these reasons, CBOE 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.⁶ Specifically, CBOE believes the proposed rule change is consistent with the requirement of Section 6(b)(5)⁷ that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, protect investors and the public interest.

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

CBOE does not believe that the proposed rule change will impose any burden on competition 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

No written comments were solicited or received.

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

The foregoing rule change, as amended, has become effective pursuant to Section 19(b)(3)(A) of the Act⁸ and

subparagraph (f)(6) of Rule 19b-4⁹ thereunder because it does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate; and CBOE has given the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. 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 necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.¹⁰

Under Rule 19b-4(f)(6)(iii) of the Act,¹¹ the proposal does not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest and CBOE is required to give the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. CBOE has requested that the Commission waive the requirement that the proposal not become operative for 30 days after the date of its filing so that the Pilot Program may continue without interruption after it would have otherwise expired on June 5, 2004. For this reason, the Commission, consistent with the protection of investors and the public interest, has determined to waive requirement that the proposal not become operative for 30 days after the date of its filing,¹² and, therefore, the proposal is effective and operative upon filing with the Commission.¹³

⁹ 17 CFR 240.19b-4(f)(6).

¹⁰ For purposes of calculating the 60-day abrogation date, the Commission considers the 60-day period to have commenced on May 28, 2004, the date CBOE filed Amendment No. 1.

¹¹ 17 CFR 240.19b-4(f)(6)(iii).

¹² For purposes only of accelerating the 30-day operative period for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ In the event that CBOE proposes to extend the Pilot Program beyond June 5, 2005, expand the number of options eligible for inclusion in the Pilot Program, or seek permanent approval of the Pilot Program, it should submit a Pilot Program report to the Commission along with the filing of such proposal. The 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

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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 Number SR-CBOE-2004-34 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 Number SR-CBOE-2004-34. 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 also will be available for inspection and copying at the principal office of CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from

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. The Commission expects the CBOE to submit a proposed rule change at least 60 days before the expiration of the Pilot Program in the event the CBOE wishes to extend, expand, or seek permanent approval of the Pilot Program.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

⁸ 15 U.S.C. 78s(b)(3)(A).

submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2004-34 and should be submitted on or before July 1, 2004.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49798; File No. SR-CBOE-2004-23]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendments Nos. 1 and 2 Thereto by the Chicago Board Options Exchange, Inc. to Permanently Approve the Modified ROS Opening Procedure Pilot Program, Which Occurs on the Settlement Date of Futures and Options on Volatility Indexes

June 3, 2004.

I. Introduction

On April 21, 2004, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to permanently approve its modified Rapid Opening System ("ROS") opening procedure, which was approved by the Commission on a pilot basis through November 17, 2004.³ On April 23, 2004, CBOE filed Amendment No. 1 to the proposed rule change.⁴ The proposed rule change, as amended, was published for comment in the **Federal Register** on April 30, 2004.⁵ The Commission received no comment letters on the proposed rule change. On May 13, 2004, CBOE filed Amendment No. 2 to the

proposed rule change.⁶ This order approves the proposed rule change, as amended.

II. Description of the Proposal

On March 24, 2004, the Commission approved the implementation of a modified ROS procedure on a pilot basis through November 17, 2004.⁷ CBOE now proposes that the modified ROS opening procedure pilot program be approved on a permanent basis. According to CBOE, the modified ROS opening procedure pilot program facilitates the trading of options and futures on volatility indexes ("Volatility Indexes") by modifying certain of the CBOE rules that govern ROS for index option series whose prices are used to derive the Volatility Indexes on which options and futures are traded.

According to CBOE, in general, Volatility Indexes provide investors with up-to-the-minute market estimates of expected near-term volatility of the prices of a broad-based group of stocks by extracting volatilities from real-time index option bid/ask quotes. Volatility Indexes are calculated using real-time quotes of the nearby and second nearby index puts and calls on established broad-based market indexes, referred to herein as a "Market Index." The futures and options on a Volatility Index expire on the Wednesday immediately prior to the third Friday of the month that immediately precedes the month in which the options used in the calculation of that index expire ("Settlement Date"). Generally, the modified ROS opening procedure allows, in part, broker-dealer orders, other than contingency orders, to be incorporated into the electronic book for purposes of the ROS opening for any index options series with respect to which a Volatility Index is calculated. The modified ROS opening procedure is used only on the final Settlement Date of the options and futures contracts on the applicable Volatility Index in each expiration month, which is when

Volatility Index settlement values are determined.⁸

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁹ In particular, the Commission believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act¹⁰ that the rules of a national securities exchange, in part, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, protect investors and the public interest.

The Commission notes that futures and options on Volatility Indexes with contract months that expire beyond November 2004 are currently being traded.¹¹ Therefore, the Commission believes that permanent approval of the modified ROS opening procedure pilot program should provide market participants with greater certainty as to the settlement process for those futures and options. The Commission also continues to believe that the modified ROS opening should ensure that broker-dealer orders are fairly incorporated into the opening,¹² and thereby enable market participants that hedge Volatility Index futures or options contract positions against option positions in the

⁸ For a detailed description on how the modified ROS opening procedure operates, see Notice, *supra* note 5.

⁹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ Telephone conversation between David Doherty, Attorney, CBOE, and Christopher Solgan, Attorney, Division, Commission, on May 24, 2004.

¹² The Commission notes that it had previously required that CBOE develop a workable plan for the electronic incorporation of non-bookable orders in ROS. This requirement was waived in light of the limited number of non-bookable orders that are present at the open and CBOE's forthcoming ability to record information on non-bookable orders under the Consolidated Options Audit Trail ("COATS") Plan when Phase V of COATS is implemented. CBOE has represented as part of this filing that it is still unable to incorporate non-bookable orders on a daily basis because of certain technological limitations with respect to index products.

Telephone conversation between David Doherty, Attorney, CBOE, and Christopher Solgan, Attorney, Division, Commission, on March 24, 2004. The Commission expects that CBOE will continue to actively monitor the quality of executions received by non-bookable orders that are not incorporated into the modified ROS opening and that CBOE will continue to explore methods to electronically incorporate non-bookable orders in the standard ROS opening in the event that non-bookable orders are more actively represented in the opening.

¹⁴ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 49468 (March 24, 2004), 69 FR 17000 (March 31, 2004) (SR-CBOE-2004-11) ("Modified ROS Opening Procedure Pilot Program Approval Order").

⁴ See letter from David Doherty, Attorney, Legal Division, CBOE, to Terri Evans, Assistant Director, Division of Market Regulation ("Division"), Commission, dated April 23, 2004 ("Amendment No. 1").

⁵ See Securities Exchange Act Release No. 49614 (April 26, 2004), 69 FR 23837 ("Notice").

⁶ See letter from David Doherty, Attorney, Legal Division, CBOE, to Terri Evans, Assistant Director, Division, Commission, dated May 12, 2004 ("Amendment No. 2"). In Amendment No. 2, CBOE amended the proposed rule text to reflect the immediate effectiveness of SR-CBOE-2004-27, which amended the modified ROS opening procedure pilot program to change the cut-off time for the submission of orders to the electronic book from 8:25 am to 8:28 am. See Securities Exchange Act Release No. 49679 (May 11, 2004), 69 FR 27957 (May 17, 2004) (Notice of Filing and Immediate Effectiveness of SR-CBOE-2004-27). The Commission notes that this is a technical, non-substantive amendment and not subject to notice and comment.

⁷ See Modified ROS Opening Procedure Pilot Program Approval Order, *supra* note 3.