

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 in the Commission's Public Reference Room. Copies of such filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-BSE-2004-02 and should be submitted by March 2, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49171; File No. SR-BSE-2004-03]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to Its Boston Options Exchange Trading Rules

February 2, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 29, 2004, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange.<sup>3</sup> The BSE has submitted the proposed rule change under Section 19(b)(3)(A) of the Act<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal effective upon filing with the Commission. 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 BSE proposes to add new paragraph (f), relating to anticipatory hedging, to Chapter III, "Business Conduct," Section 4, "Prevention of the Misuse of Material Nonpublic Information," of the Boston Options Exchange trading rules ("BOX Rules"). Proposed new language is *italicized*.

\* \* \* \* \*

#### Chapter III Business Conduct

##### Sec. 4 Prevention of the Misuse of Material NonPublic Information

(a)-(e) no change

*(f) It may be considered conduct inconsistent with just and equitable principles of trade for any Participant or person associated with a Participant who has knowledge of all material terms and conditions of:*

*(i) an order and a solicited order,*

*(ii) an order being facilitated or submitted to the Price Improvement Period, or*

*(iii) orders being crossed;*

*the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option for the same underlying security as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument until (a) the terms and conditions of the order and any changes in the terms and conditions of the order of which the Participant or person associated with the Participant has knowledge are disclosed to the trading crowd, or (b) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received. The terms of an order are "disclosed" to the trading crowd on BOX when the order is entered into the BOX Book or the Price Improvement Period, as defined in Chapter V, Section 18 of these Rules. For purposes of this Paragraph (f), an order to buy or sell a "related instrument" means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.*

\* \* \* \* \*

#### 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 Exchange 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 Exchange 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

The purpose of the proposed rule change is to add new paragraph (f), relating to anticipatory hedging, to Chapter III, "Business Conduct," Section 4, "Prevention of the Misuse of Material Nonpublic Information," of the BOX Rules. Currently, Chapter III, Section 4 of the BOX Rules contains policies and procedural requirements, as well as definitional language, regarding the obligations of Boston Options Exchange participants ("BOX Participants") to prevent the misuse of material nonpublic information. To remain consistent with similar rules of other options exchanges, the BSE is proposing to adopt new paragraph (f) regarding anticipatory hedging. The rest of Chapter III, Section 4, will remain unchanged.

Paragraph (f) would expressly prohibit any BOX Participant or person associated with a BOX Participant who has knowledge of the material terms and conditions of a solicited order, an order being facilitated or submitted to the Price Improvement Period ("PIP"),<sup>6</sup> or orders being crossed, the execution of which are imminent, from entering, based on such knowledge, an order to buy or sell an option for the same underlying security; an order to buy or sell the security underlying such class; or an order to buy or sell any related instrument. The prohibition would remain in effect until the terms and conditions of such solicited, facilitated, PIP or crossed order are disclosed to the trading crowd, or until the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received.

To allow BOX Participants to know what constitutes a "related instrument"

<sup>6</sup> See BOX Rules Chapter V, Section 18.

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> File No. SR-BSE-2004-03 replaces and supersedes File No. SR-BSE-2003-24. See letter from John Boese, Vice President, Legal and Compliance, BSE, dated January 23, 2004.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

in reference to an index option, paragraph (f) clarifies that an order to buy or sell a related instrument means, in reference to an index option, an order to buy or sell securities comprising 10% or more of the component securities in the index or an order to buy or sell a futures contract on an economically equivalent index.

Under the proposal, a violation of paragraph (f) may be considered conduct inconsistent with just and equitable principles of trade.<sup>7</sup> The purpose of the proposed rule is to expressly prohibit anticipatory hedging that is based on inside information. The Exchange believes that a codified prohibition, and the proposed language stating that a violation of the rule may be considered conduct inconsistent with just and equitable principles of trade, should function as a deterrent to possible manipulative practices based on inside information.<sup>8</sup>

## 2. Statutory Basis

The Exchange believes that the proposal is consistent with the requirements of Section 6(b) of the Act,<sup>9</sup> in general, and Section 6(b)(5) of the Act,<sup>10</sup> in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest by granting the Exchange greater authority to regulate anticipatory hedging.

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

The BSE 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

The BSE has neither solicited nor received comments on the proposed rule change.

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

The BSE has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>12</sup> 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 thirty days from the date on which it was filed, 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. The BSE provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing date.

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.<sup>13</sup> The BSE has requested that the Commission waive the 30-day operative delay to allow the BSE to remain competitive with other options exchanges that currently have similar rules in effect. The Commission believes waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration will allow the BSE to institute its anticipatory hedging rules immediately. For these reasons, the Commission, consistent with the protection of investors and the public interest has determined to make the proposed rule change operative as of January 29, 2004.

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.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change 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](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-BSE-2004-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, your 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 in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the BSE. All submissions should refer to File No. SR-BSE-2004-03 and should be submitted by March 2, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>7</sup> See BSE Rules of the Board of Governors Chapter II, Section 14, stating that a member, member organization, or person associated with or employed by a member or member organization shall not engage in conduct inconsistent with just and equitable principles of trade. Other BOX Rules expressly reference just and equitable principles of trade. See, e.g., BOX Rules Chapter V, Section 18(f) and (j), Section 27.01 and Chapter VII, Section 1(d). The lack of express reference in other BSE rules should not be construed as waiving the ability to make a violation of Chapter II, Section 14 of the BSE Rules of the Board of Governors, co-exist with any other violation, depending on the facts and circumstances of the case. The Exchange believes that a violation of the existing crossing, facilitation and solicitation provisions of the BOX Rules could be a violation of just and equitable principles of trade and could be subject to disciplinary action as such. In addition, a violation of paragraph (f) of Chapter III, Section 4 of the BOX Rules, for instance, could be in and of itself a stand-alone violation.

<sup>8</sup> Depending on the facts and circumstances surrounding individual cases, anticipatory hedging activity may be a violation of other BSE Rules or rules under the Act.

<sup>9</sup> 15 U.S.C. 78f(b).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

<sup>13</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> 17 CFR 200.30-3(a)(12).