

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49791; File No. SR-CBOE-2004-20]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 by the Chicago Board Options Exchange, Inc., Relating to the \$5 Quotation Spread Pilot Program

June 2, 2004.

#### I. Introduction

On April 5, 2004, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), 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> a proposed rule change to limit the applicability of the \$5 quote spreads permitted under the CBOE's quote spread pilot program ("Pilot Program")<sup>3</sup> to quotations that are submitted electronically to the CBOE's Hybrid Trading System ("Hybrid"). The CBOE filed Amendment No. 1 to the proposal on April 20, 2004.<sup>4</sup>

The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on April 27, 2004.<sup>5</sup> The Commission received no comments regarding the proposal. This order approves the proposed rule change, as amended.

#### II. Description of the Proposal

In January 2004, the CBOE implemented a six-month Pilot Program, which expires on June 29, 2004, that permits quote spread parameters of up to \$5, regardless of the price of the bid,

for up to 200 options classes traded on Hybrid.<sup>6</sup> The CBOE subsequently expanded the Pilot Program to include all options classes traded on Hybrid.<sup>7</sup> The CBOE proposes to amend the Pilot Program to limit the applicability of the \$5 quote spreads permitted under the Pilot Program to quotations that are submitted electronically to Hybrid. Thus, under the proposal, market makers in Hybrid classes would not be permitted to give verbal quotes in open outcry in accordance with the terms of the Pilot Program. Instead, market makers quoting Hybrid classes in open outcry would be required to give verbal quotes that comply with the quote width requirements established in CBOE Rule 8.7(b)(iv).<sup>8</sup>

#### III. Discussion

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<sup>9</sup> and, in particular, with the requirements of Section 6(b)(5) of the Act,<sup>10</sup> which requires, among other things, that the rules of a national securities exchange be 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 to protect investors and the public interest.

As described more fully above, the proposal limits the quote width relief provided under the Pilot Program to options quotations that are submitted electronically to Hybrid. In its proposal, the CBOE noted that, unlike an options market maker quoting in open outcry, an options market maker quoting electronically could execute numerous transactions before having the ability to adjust his or her quotes to reflect new pricing information. For this reason, a market maker quoting in open outcry has less need for the quote spread relief provided under the Pilot Program than a market maker quoting electronically. Accordingly, by limiting the Pilot

Program to quotes that are submitted electronically to Hybrid, the Commission believes that the proposal is designed to tailor the quote spread relief provided under the Pilot Program to the circumstances where it is most likely to be needed, thereby protecting investors and the public interest.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (SR-CBOE-2004-20), as amended, is approved on a pilot basis until June 29, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49792; File No. SR-NSX-2004-05]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by National Stock Exchange To Extend the Liquidity Provider Fee and Rebate Pilot Program

June 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 May 28, 2004, National Stock Exchange ("Exchange")<sup>3</sup> 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. The Exchange filed this proposal pursuant to section 19(b)(3)(A) of the Act<sup>4</sup> and Rule 19b-4(f)(6)<sup>5</sup> thereunder, which renders the proposal effective upon filing with the Commission.<sup>6</sup> The Commission is

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

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

<sup>3</sup> See Securities Exchange Act Release No. 49153 (January 29, 2004), 69 FR 5620 (February 5, 2004) (notice of filing and immediate effectiveness of File No. SR-CBOE-2003-50) (implementing the Pilot Program through June 29, 2004) ("Pilot Program Notice").

<sup>4</sup> See letter from Steve Youhn, CBOE, to Nancy Snow, Division of Market Regulation, Commission, dated April 19, 2004 ("Amendment No. 1"). In Amendment No. 1, CBOE revised the text of the proposed rule to change a reference in CBOE Rule 8.7(b)(iv)(A) from "subparagraph (iv)(a)" to "subparagraph (iv)(A)."

<sup>5</sup> See Securities Exchange Act Release No. 49588 (April 21, 2004), 69 FR 22895.

<sup>6</sup> See Pilot Program Notice, *supra* note 3.

<sup>7</sup> See Securities Exchange Act Release No. 49318 (February 25, 2004), 69 FR 10085 (March 3, 2004) (notice of filing and immediate effectiveness of File No. SR-CBOE-2004-10).

<sup>8</sup> Under CBOE Rule 8.7(b)(iv), the allowable bid-ask differentials are: \$0.25 for options under \$2, \$0.40 for options between \$2 and \$5, \$0.50 for options between \$5 and \$10, \$0.80 for options between \$10 and \$20, and \$1.00 for options above \$20.

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

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

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</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> The Exchange was formerly known as The Cincinnati Stock Exchange. See Securities Exchange Act Release No. 48774 (November 12, 2003), 68 FR 65332 (November 19, 2003)(SR-CSE-2003-12).

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

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

<sup>6</sup> The Exchange provided the Commission with written notice of its intention to file the proposed rule change on May 21, 2004. The Commission reviewed the Exchange's submission, and asked the Exchange to file the instant proposed rule change, pursuant to Rule 19b-4(f)(6) under the Act. 17 CFR 240.19b-4(f)(6).

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 Exchange has a liquidity provider fee and rebate program ("Program"), which the Exchange established in SR-CSE-2002-16.<sup>7</sup> The Program is currently in effect, and is scheduled to expire on June 30, 2004.<sup>8</sup> With the instant proposed rule change, the Exchange extends the Program through June 30, 2005. The Exchange is making no substantive changes to the Program, other than extending its operation through June 30, 2005. The text of the proposed rule change is available at the Exchange and at the Commission.<sup>9</sup>

### 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.

<sup>7</sup> Securities Exchange Act Release No. 46848 (November 19, 2002), 67 FR 70793 (November 26, 2002).

<sup>8</sup> The Program was originally set to expire on March 31, 2003. It has been extended three times, with the most recent extension due to expire on June 30, 2004. See Securities Exchange Act Release Nos. 47596 (March 28, 2003), 68 FR 16594 (April 4, 2003) (SR-CSE-2003-03) (extending the pilot until September 30, 2003); 48584 (October 2, 2003), 68 FR 58368 (October 9, 2003) (SR-CSE-2003-13) (extending the pilot until December 31, 2003); and 48891 (December 8, 2003), 68 FR 69738 (December 15, 2003) (SR-CSE-2003-14) (extending the pilot until June 30, 2004).

<sup>9</sup> The Commission notes that the Exchange filed the proposed rule change with the intention of extending the Program's operation through June 30, 2005; however, the proposed rule language states the Program will operate "until June 30, 2005." With the Exchange's permission, the Commission has conformed the proposed rule language to reflect that the Program will operate through June 30, 2005. The Commission did not require the Exchange to file an amendment to accomplish this technical change. See June 1, 2004 email exchange between Jennifer Lamie, Assistant General Counsel and Secretary, NSX, and Joseph P. Morra, Special Counsel, Division of Market Regulation, Commission.

#### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

In SR-CSE-2002-16,<sup>10</sup> the Exchange established the Program, which provides a transaction credit for liquidity providers that is paid by liquidity takers on each intra-Exchange execution<sup>11</sup> in Nasdaq securities. To establish the Program, the Exchange amended CSE Rule 11.10A(g)(1) by adding subparagraph (B) to charge the liquidity taker (*i.e.*, the party executing against a previously displayed quote/order) \$0.004 per share. The Exchange then passes on to the liquidity provider (*i.e.*, the party providing the displayed quote/order) \$0.003 per share, allowing the Exchange to retain \$0.001 per share. With the instant proposed rule change, the Exchange is extending the Program through June 30, 2005.<sup>12</sup> The Exchange is making no other changes to the Program as it currently operates.

##### 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>13</sup> in general, and furthers the objectives of section 6(b)(5)<sup>14</sup> in particular, in that it is designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanism of a free and open market and a national market system and, generally, in that it protects investors and the public interest. The Exchange believes that the proposed rule change is also consistent with section 6(b)(4) of the Act,<sup>15</sup> in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among Exchange members by crediting members on a *pro rata* basis.

<sup>10</sup> Securities Exchange Act Release No. 46848 (November 19, 2002), 67 FR 70793 (November 26, 2002).

<sup>11</sup> An "intra-Exchange execution" (referred to in the original filing as an "intra-CSE execution") is any transaction that is executed on the Exchange for which the executing member on the buy-side of the transaction differs from the executing member on the sell-side of the transaction.

<sup>12</sup> The Exchange understands that the Commission's Proposed Regulation NMS ("Reg. NMS") may have an impact on the Program. Accordingly, the Exchange will undertake to work with the Commission to ensure that the Program would be consistent with the rules and regulations contained in Reg. NMS, should it be adopted.

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> 15 U.S.C. 78f(b)(4).

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

#### 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 in connection with the proposed rule change.

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

Because the foregoing proposed rule change does not:

(i) Significantly affect the protection of investors or the public interest;

(ii) Impose any significant burden on competition; and

(iii) Become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to section 19(b)(3)(A) of the Act<sup>16</sup> and Rule 19b-4(f)(6)<sup>17</sup> thereunder. At any time within 60 days of the filing of the 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. 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](mailto:rule-comments@sec.gov). Please include File Number SR-NSX-2004-05 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-NSX-2004-05. This file number should be included on the subject line if e-mail is used. To help the

<sup>16</sup> 15 U.S.C. 78s(b)(3)(A).

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

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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NSX. 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-NSX-2004-05 and should be submitted on or before June 30, 2004.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49802; File No. SR-PCX-2004-31]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. Relating to Exchange Fees and Charges

June 3, 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 April 14, 2004, the Pacific Exchange, Inc. ("PCX" 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 PCX. The proposed rule change has been filed by PCX as establishing or changing a due, fee, or other charge under Section 19(b)(3)(A)(ii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. On May 21, 2004, the Exchange filed Amendment No. 1 to the proposal.<sup>5</sup> 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

PCX is proposing to amend its Schedule of Fees and Charges by reinstating an Order Cancellation fee. The text of the proposed rule change is available at the Exchange 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 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 for, the Proposed Rule Change

###### 1. Purpose

The Exchange represents that it previously established the Order Cancellation fee to address operational problems and costs resulting from the practice of market participants canceling orders immediately after they route those orders electronically to the PCX.<sup>6</sup> The Exchange states that, while

the Order Cancellation fee was intended to temper activity among trading participants who immediately cancelled orders without routing significant order flow to the Exchange, as applied, it had the unintended effect of penalizing Clearing Members because the Exchange did not have the methodology to correlate the cancellation of an order with the correspondent activity of a specific Clearing Member. On May 30, 2003, the Exchange filed a proposed rule change that repealed the Order Cancellation fee then in effect,<sup>7</sup> despite the fact that operational problems and costs resulting from the practice of market participants canceling orders immediately after they place such orders continued to be problematic.

The Exchange represents that it has effected technological enhancements to its billing system and is now able to ascertain the identity of the Clearing Member's customer who cancels orders. The Exchange states that this enhancement allows the Exchange to evaluate order cancellations beyond the aggregate cancellations cleared through a Clearing Member, thus providing the Clearing Members a vehicle for passing through any resulting charges to their customers. Therefore, the Exchange seeks to reinstate the Order Cancellation fee at \$1.00 per electronically routed order cancelled and apply the fee to a Clearing Member who electronically cancels orders on behalf of its customers or on its own behalf when it self-clears in any month where both of the following conditions are satisfied: (i) The total number of orders canceled for any customer or for itself equals or exceeds 500 contracts; and (ii) the ratio of such canceled orders to executed orders equals or exceeds two to one. The Exchange represents that it will continue to bill the Clearing Member, but the Clearing Member will have the opportunity to pass the fee along to its customers.

###### 2. Statutory Basis

The Exchange believes that the proposal is consistent with section 6(b) of the Act, in general, and section 6(b)(4) of the Act, in particular, in that it provides for the equitable allocation of reasonable fees among its members.

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

The Exchange does not believe that the proposed rule change will impose

(Notice of Filing and Immediate Effectiveness of SR-PCX-2001-47).

<sup>7</sup> See Securities Exchange Act Release No. 48031 (June 13, 2003), 68 FR 37189 (June 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PCX-2003-25).

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

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

<sup>5</sup> See Letter from Mai S. Shiver, Acting Director/Senior Counsel, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated May 19, 2004. In Amendment No. 1, the Exchange revised the purpose section of the proposed rule change and the rule text to clarify that the Order Cancellation fee applies to a Clearing Member who electronically cancels orders on behalf of its customers or on its own behalf when it self-clears, when the conditions specified in the rule are satisfied. Amendment No. 1 supersedes and replaces the text of the proposed rule change in its entirety.

<sup>6</sup> See Securities Exchange Act Release No. 45262 (January 9, 2002), 67 FR 2266 (January 16, 2002)

<sup>18</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.