

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50669; File No. SR-BSE-2004-47)

November 16, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to \$5 Quotation Spreads on the Boston Options Exchange

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 October 29, 2004, the Boston Stock Exchange ("BSE" 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 Exchange. 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 Exchange proposes to amend a section of its Boston Options Exchange rules regarding quote spread requirements. The text of the proposed rule change appears below. Additions are in italics. Deleted items are in brackets.

* * *

Chapter VI Market Makers

Sec. 5 Obligations of Market Makers

(a)

(i)–(vi) No change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(vii) Price options fairly by, among other things, bidding and offering so as to create differences of no more than [~~\$.25~~]\$5 between the bid and the offer following the pre-opening phase for each options contract. During the pre-opening phase, spread differentials shall be no more than \$.25 between the bid and offer for each options contract for which the bid is less than \$2, no more than \$.40 where the bid is at least \$2 but does not exceed \$5, no more than \$.50 where the bid is more than \$5 but does not exceed \$10, no more than \$.80 where the bid is more than \$10 but does not exceed \$20, and no more than \$1.00 where the bid is \$20 or greater, provided that BOX may establish differences other than the above for one or more options series. The bid/offer differentials stated above shall not apply to in-the-money options series where the underlying securities market is wider than the differentials set forth above. For these series, the bid/ask differential may be as wide as the quotation on the primary market of the underlying security.

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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 permit quote spread parameters of up to \$5, regardless of the price of the bid, for all options classes traded on the Boston Options Exchange (“BOX”). Currently, Chapter VI, Section 5(a)(vii) of the BOX Rules establishes maximum bid-ask differentials (also referred to as quote spread requirements) that vary from \$0.25 to \$1.00, depending upon the price of the option.³ The primary purpose of the quote spread requirements is to help maintain narrow spreads in options. These requirements can have the unintended consequence of requiring market makers to quote at prices that are unnecessarily narrow, thereby exposing them to great risk if markets move quickly.

Given the competitive market making structure of BOX, and the existence of vigorous inter-market competition, the mandatory quote spread requirements may not be necessary to ensure narrow and competitive spreads in options. In this regard, the BOX market structure creates strong incentives for competing market makers and other market participants to disseminate competitive prices. On BOX, each market maker quotes independently, and customers and broker-dealers can enter limit orders at prices better than those posted by market makers. BOX automatically collects this trading interest information, calculates the BOX best bid and offer, and disseminates that value to the Options Price Reporting Authority. Accordingly, the BOX market is competitive, accessible and transparent.

³ The allowable bid-ask differential 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. See Chapter VI, Section 5(a)(vii) of the BOX Rules.

In addition, market participants in BOX have strong incentives to quote competitively. BOX allocates incoming orders based on the price and time of receipt of orders and quotes on the book. A market participant, including a market maker, will not participate in any trade if other orders or quotes have time priority at the same price. Therefore, all BOX market participants have incentive to quote the best price first. Also, BOX's unique Market Maker Prime Rule⁴ gives market makers an added incentive to quote the best price first in order to gain an enhanced trade allocation in the BOX Price Improvement Period ("PIP").⁵ In the BOX approval order the Commission stated that it "believes that the BSE's proposal to give priority to a Market Maker who quotes aggressively before a PIP is initiated [Market Maker Prime], is consistent with the Act and may provide a further incentive for Market Makers to publicly display their best quotes, which would benefit all options market participants."⁶

Given BOX's NBBO protections⁷ as well as through the Options Market Linkage Plan, market participants have even stronger incentives to quote at the best price, lest incoming orders be filled away. Thus, inter- and intra-market competitive forces provide strong incentives for market participants to quote competitively and enter quotes and orders that improve the price and depth of the market.

⁴ See Chapter V, Section 19 of the BOX Rules.

⁵ See Chapter V, Section 18 of the BOX Rules.

⁶ See Securities Exchange Act Release No. 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004) (SR-BSE-2002-15).

⁷ See Chapter V, Section 16(b) of the BOX Rules. BOX filters all inbound orders to ensure that these orders will not execute at a price outside the current national best bid or offer.

For these reasons, BSE proposes to widen the allowable spread on BOX to \$5. The proposed quote spread requirements will apply after the opening. During the opening, market makers will be required to quote in accordance with the traditional bid-ask width requirements. The \$5 quotation requirements would become operative immediately following the opening.

BSE notes that its proposal is similar to pilot programs adopted by the International Securities Exchange, Inc. (“ISE”) and the Chicago Board Options Exchange, Inc. (“CBOE”) that the SEC recently approved on a permanent basis,⁸ and a rule change proposed by the Pacific Exchange, Inc. (“PCX”) that was immediately effective upon filing.⁹

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹⁰ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹¹ in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

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

The Exchange 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

⁸ See Securities Exchange Act Release Nos. 50015 (July 14, 2004), 69 FR 43872 (July 22, 2004) (SR-ISE 2003-22); and 50079 (July 26, 2004), 69 FR 45858 (July 30, 2004) (SR-CBOE-2004-44).

⁹ See Securities Exchange Act Release No. 50538 (October 14, 2003), 69 FR 62105 (October 22, 2004) (SR-PCX-2004-89).

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

The Exchange 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

As noted above, this proposal is similar to pilot programs adopted by the ISE and the CBOE that the Commission recently approved on a permanent basis,¹² and a rule change proposed by PCX that was immediately effective on filing.¹³ Neither the ISE proposal nor the CBOE proposal received any public comments. Accordingly, the BSE believes that this proposal does not raise any new issues or regulatory concerns. The Exchange has therefore designated the proposed rule change as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act¹⁴ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁵ Consequently, because the foregoing 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 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, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁶ and Rule 19b-4(f)(6) thereunder.¹⁷

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

¹² See supra, note 8.

¹³ See supra, note 9.

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(6).

¹⁶ 15 U.S.C. 78s(b)(3)(A).

¹⁷ 17 CFR 240.19b-4(f)(6).

public interest. The Exchange has requested that the Commission waive the 30-day operative delay specified in Rule 19b-4(f)(6) because the proposal provides quote width relief similar to that provided under the rules of other exchanges.¹⁸ Accordingly, the Exchange 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. In addition, the Exchange believes that its request is consistent with the protection of investors and the public interest and that good cause exists, including the need to keep BOX competitive and efficient.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.¹⁹ Specifically, the Commission believes that allowing the BSE to implement \$5 quotation spread parameters like those adopted by the ISE, the PCX, and the CBOE will help the BOX to compete with those exchanges. The Commission believes that the BSE's proposal raises no new issues or regulatory concerns that the Commission did not consider in approving the ISE and CBOE proposals. For these reasons, the Commission designates that the proposal become operative immediately.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that the action is necessary or appropriate in the public interest, for the protection of investors, or would otherwise further the purposes of the Act.

IV. Solicitation of Comments

¹⁸ See supra, notes 8 and 9.

¹⁹ For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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. Please include File Number SR-BSE-2004-47 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-2004-47. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of this filing also will be available for inspection and copying at the principal office of the 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-2004-47 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority²⁰.

Margaret H. McFarland
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).