SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49791; File No. SR-CBOE-2004-20)

June 2, 2004

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

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")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to limit the applicability of the $5 quote spreads permitted under the CBOE's quote spread pilot program ("Pilot Program")[3] 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.[4]

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

II. Description of the Proposal

---

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 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").

4 See letter from Steve Youhn, CBOE, to Nancy Sanow, 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)."

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

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.[6] The CBOE subsequently expanded the Pilot Program to include all options classes traded on Hybrid.[7] 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).[8]

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[9] and, in particular, with the requirements of Section 6(b)(5) of the Act,[10] 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

---

6 See Pilot Program Notice, supra note 3.

7 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).

8 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.

9 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).

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

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,[11] 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.[12]

Margaret H. McFarland
Deputy Secretary

---

11 15 U.S.C. 78s(b)(2).

12 17 CFR 200.30-3(a)(12).