

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55155; File No. SR-BSE-2006-49]

### Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Order Granting Approval To Proposed Rule Change as Modified by Amendment No. 1 Thereto, To Implement a Pilot Program To Quote Options in Pennies

January 23, 2007.

#### I. Introduction

On November 17, 2006, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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 amend the Boston Options Exchange ("BOX") Rules to permit certain option classes to be quoted in pennies on a pilot basis. The proposed rule change was published for comment in the **Federal Register** on November 27, 2006.<sup>3</sup> The Commission received no comment letters on the proposed rule change. On January 5, 2007, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change as modified by Amendment No. 1.

#### II. Description of the Proposal

BOX proposes to amend its rules to permit certain option classes to be quoted in pennies during a six-month pilot ("Penny Pilot Program"), which would commence on January 26, 2007. Specifically, the Exchange proposes to amend Section 6 ("Minimum Trading Increments") and to add a new section, Section 33, ("Penny Pilot Program") to Chapter V ("Doing Business on BOX") of the BOX Rules.

Currently, all six options exchanges, including BOX, quote options in nickel and dime increments. The minimum price variation for quotations in options series that are quoted at less than \$3 per contract is \$0.05 and the minimum price variation for quotations in options series that are quoted at \$3 per contract or greater is \$0.10. Under the Penny Pilot Program, beginning on January 26,

2007, market participants would be able to begin quoting in penny increments in certain series of option classes.

The Penny Pilot Program would include the following thirteen options: Ishares Russell 2000 (IWM); NASDAQ-100 Index Tracking Stock (QQQQ); SemiConductor Holders Trust (SMH); General Electric Company (GE); Advanced Micro Devices, Inc. (AMD), (Microsoft Corporation (MSFT); Intel Corporation (INTC); Caterpillar, Inc. (CAT); Whole Foods Market, Inc. (WFMI); Texas Instruments, Inc. (TXN); Flextronics International Ltd. (FLEX); Sun Microsystems, Inc. (SUNW); and Agilent Technologies, Inc. (A).

The minimum price variation for all classes included in the Penny Pilot Program, except for the QQQQs, would be \$0.01 for all quotations in option series that are quoted at less than \$3 per contract and \$0.05 for all quotations in option series that are quoted at \$3 per contract or greater. The QQQQs would be quoted in \$0.01 increments for all options series.

BOX commits to deliver a report to the Commission during the fourth month of the pilot, which would be composed of data from the first three months of trading. The report would analyze the impact of penny pricing on market quality and options system capacity.

#### III. Discussion

After careful review of the proposal, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>5</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>6</sup> which requires, among other things, that the rules of an 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, in general, to protect investors and the public interest.

The Commission believes that the implementation of a limited six-month Penny Pilot Program by BOX and the five other options exchanges will provide valuable information to the exchanges, the Commission and others about the impact of penny quoting in the options market. In particular, the Penny Pilot Program will allow analysis

of the impact of penny quoting on: (1) Spreads; (2) transaction costs; (3) payment for order flow; and (4) quote message traffic.

The Commission believes that the thirteen options classes to be included in the penny pilot program represent a diverse group of options classes with varied trading characteristics. This diversity should facilitate analyses by the Commission, the options exchanges and others. The Commission also believes that the Penny Pilot Program is sufficiently limited that it is unlikely to increase quote message traffic beyond the capacity of market participants' systems and disrupt the timely receipt of quote information.

Nevertheless, because the Commission expects that the Penny Pilot Program will increase quote message traffic, the Commission has already approved the Exchange's proposal to reduce the number of quotations it disseminates.<sup>7</sup>

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-BSE-2006-49), as modified by Amendment No. 1, be, and hereby is, approved on a six-month pilot basis, which will commence on January 26, 2007.

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

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55176; File No. SR-CBOE-2007-08]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto Relating to the Establishment of a Pilot Program That Increases Position and Exercise Limits for Options on the iShares® Russell 2000® Index Fund

January 25, 2007.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

<sup>7</sup> BOX submitted its proposed quote mitigation strategy in SR-BSE-2006-48. See Securities Exchange Act Release No. 55073 (January 9, 2007), 72 FR 2047 (January 17, 2006).

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<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> See Securities Exchange Act Release No. 54789 (November 20, 2006), 71 FR 68654.

<sup>4</sup> Amendment No. 1 proposed to replace Glamis Gold, which was delisted, with Agilent Tech, Inc. in the list of options classes permitted to be quoted in pennies. Amendment No. 1 is technical in nature, and the Commission is not publishing Amendment No. 1 for public comment.

<sup>5</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 22, 2007, the Chicago Board Options Exchange, Incorporated ("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 substantially prepared by CBOE. On January 22, 2007, CBOE submitted Amendment No. 1 to the proposed rule change. CBOE has filed the proposal pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</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, as amended, from interested persons.

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

CBOE proposes to amend Rule 4.11 to exempt options on the iShares<sup>®</sup> Russell 2000<sup>®</sup> Index Fund ("IWM") from the position and exercise limits provided for under the Rule 4.11 Pilot Program and to increase the standard position and exercise limits for IWM as part of a six-month pilot ("Rule 4.11 IWM Pilot Program"). The text of the proposed rule change is available at CBOE, the Commission's Public Reference Room, and <http://www.cboe.com>.

### **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**

The Exchange proposes to amend Interpretation and Policy .07 to Rule 4.11 on a six-month pilot basis to exempt options on IWM from the Rule 4.11 Pilot Program. Under the Rule 4.11

Pilot Program, the position and exercise limits for IWM would be reduced on January 22, 2007 from 500,000 to 250,000 contracts. The Exchange now proposes to allow position and exercise limits for options on IWM to remain at 500,000 contracts on a pilot basis, from January 22, 2007 through July 22, 2007.

In June 2005, as a result of a 2-for-1 stock split, the position limit for IWM options was temporarily increased from 250,000 contracts (covering 25,000,000 shares) to 500,000 contracts (covering 50,000,000 shares). At the time of the split, the furthest IWM option expiration date was January 2007. Therefore, the temporary increase of the IWM position limit will revert to the pre-split level (as provided for in connection with the Rule 4.11 Pilot Program) of 250,000 contracts after expiration in January 2007, or on January 22, 2007.<sup>5</sup>

The Exchange believes that a position limit of 250,000 contracts is too low and may be a deterrent to the successful trading of IWM options. Importantly, options on IWM are 1/10th the size of options on the Russell 2000<sup>®</sup> Index ("RUT"), which have a position limit of 50,000 contracts.<sup>6</sup> Traders who trade IWM options to hedge positions in RUT options are likely to find a position limit of 250,000 contracts in IWM options too restrictive and insufficient to properly hedge. For example, if a trader held 50,000 RUT options and wanted to hedge that position with IWM options, the trader would need—at a minimum—500,000 IWM options to properly hedge the position. Therefore, the Exchange believes that a position limit of 250,000 contracts is too low and may adversely affect market participants' ability to provide liquidity in this product.

Additionally, IWM options have grown to become one of the largest options contracts in terms of trading volume. For example, the volume in options on IWM set a new single-day record on June 8, 2006, when 760,803 contracts (120,229 calls and 640,574 puts) traded on that day. This record level volume beat the previous single-day high of 727,521 contracts on May 17, 2006. Further, over the previous six months, the average daily CBOE trading

volume of IWM options has been 187,190 contracts and a total of 23,960,382 contracts have traded on the Exchange.

As a result, the Exchange proposes that options on IWM be subject to position and exercise limits of 500,000 contracts on a pilot basis to run from January 22, 2007 through July 22, 2007.<sup>7</sup> The Exchange believes that increasing position and exercise limits for IWM options will lead to a more liquid and more competitive market environment for IWM options that will benefit customers interested in this product.

The Exchange would require that each member or member organization that maintains a position on the same side of the market in excess of 10,000 contracts in the IWM option class, for its own account or for the account of a customer report certain information.<sup>8</sup> This data would include, but would not be limited to, the option position, whether such position is hedged and if so, a description of the hedge, and if applicable, the collateral used to carry the position. Exchange market-makers (including DPMs) would continue to be exempt from this reporting requirement as market-maker information can be accessed through the Exchange's market surveillance systems. In addition, the general reporting requirement for customer accounts that maintain a position in excess of 200 contracts will remain at this level for IWM options.<sup>9</sup>

##### **2. Statutory Basis**

CBOE believes that the proposed rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act,<sup>10</sup> 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, in general, to 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 that is not necessary or appropriate in furtherance of the purposes of the Act.

<sup>5</sup> See CBOE Research Circular #RS05-380, at 12.

<sup>6</sup> See CBOE Rule 24.4(a); see also Securities Exchange Act Release Nos. 45309 (January 18, 2002), 67 FR 3757 (January 25, 2002) (SR-CBOE-2001-44) (increase of position and exercise limits to 300,000 for QQQ options); 47346 (February 11, 2003), 68 FR 8316 (February 20, 2003) (SR-CBOE-2002-26) (increase of position and exercise limits to 300,000 for DIA options); and 51041 (January 14, 2005), 70 FR 3408 (January 24, 2005) (SR-CBOE-2005-06) (increase of position and exercise limits on Standard and Poor's Depository Receipts<sup>®</sup> from 75,000 to 300,000).

<sup>7</sup> Pursuant to Interpretation and Policy .02 to CBOE Rule 4.12, the exercise limit established under Rule 4.12 for IWM options shall be equivalent to the position limit prescribed for IWM options in Interpretation and Policy .07 under Rule 4.11. The increased exercise limits would only be in effect during the pilot period, to run from January 22, 2007 through July 22, 2007. See Amendment No. 1 to the proposed rule change.

<sup>8</sup> See CBOE Rule 4.13(b).

<sup>9</sup> See CBOE Rule 4.13(a).

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

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

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

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

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

*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 with respect to the proposed rule change.

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

Because the forgoing rule change does not: (1) Significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6) thereunder.<sup>12</sup>

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.<sup>13</sup> However, Rule 19b-4(f)(6)(iii)<sup>14</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would permit position and exercise limits for options on IWM to remain at 500,000 option contracts for a six-month pilot period. For this reason, the Commission designates the proposed rule change to be effective and operative upon filing with the Commission.<sup>15</sup>

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.

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

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

<sup>13</sup> 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Commission has decided to waive the five-day pre-filing notice requirement.

<sup>14</sup> *Id.*

<sup>15</sup> For the purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

**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-CBOE-2007-08 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2007-08. 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. Copies of the 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 submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2007-08 and should be submitted on or before February 22, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-55154; File No. SR-CBOE-2006-92]

**Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval to Proposed Rule Change as Modified by Amendment No. 1 Thereto, Relating to the Penny Pilot Program**

January 23, 2007.

**I. Introduction**

On November 8, 2006, the Chicago Board Options Exchange, Incorporated ("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"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rules to permit certain option classes to be quoted in pennies on a pilot basis. The proposed rule change was published for comment in the **Federal Register** on November 29, 2006.<sup>3</sup> The Commission received one comment letter on the proposed rule change.<sup>4</sup> On January 9, 2007, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>5</sup> The Exchange responded to the comment letter on January 10, 2007.<sup>6</sup> This order approves the proposed rule change as modified by Amendment No. 1.

<sup>16</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> See Securities Exchange Act Release No. 54805 (November 21, 2006), 71 FR 69151.

<sup>4</sup> See letter to Nancy M. Morris, Secretary, Commission, from Christopher Nagy, Chair, Securities Industry and Financial Markets Association ("SIFMA") Options Committee, dated December 20, 2006 ("SIFMA Letter").

<sup>5</sup> Amendment No. 1 revised the Regulatory Circular CBOE will distribute to its members to reflect the replacement of Glamis Gold, which was delisted, with Agilent Tech, Inc. in the list of options classes permitted to be quoted in pennies. Amendment No. 1 is technical in nature, and the Commission is not publishing Amendment No. 1 for public comment.

<sup>6</sup> See letter to Nancy M. Morris, Secretary, Commission, from Patrick Sexton, Associate General Counsel, CBOE, dated January 10, 2007 ("CBOE Letter").