

The Commission believes that the proposal to permit CBOE market makers to widen their quotes for options where the bid price is less than \$2 under specific and limited circumstances is reasonable because when one of the Triggering Events occurs it may be difficult to accurately price an option based on the security. In addition, the Commission believes that CBOE's proposal to program its systems, or to requires its market makers to program their systems, to automatically widen the quote upon the occurrence of a Triggering Event and to automatically return the quote to its normal bid-ask differential when the Triggering Event ceases should ensure that the double-width relief is only used when permitted under the rule. Accordingly, the Commission believes that the proposal is narrowly tailored to permit quote width relief only in the specific and limited circumstances provided in the proposal.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-CBOE-2003-25), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48982; File No. SR-CHX-2003-17]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Incorporated Relating to Automatic Quotations

December 23, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 16, 2003, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items

efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

have been prepared by the Exchange. On November 26, 2003, the Exchange filed Amendment No. 1 to the proposal.³ 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

The Exchange proposes to delete an interpretation of CHX Article XX, Rule 7, which governs recognized quotations. The text of the proposed rule change is available at the Commission and at the CHX.

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 CHX included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The CHX 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 proposed rule change would delete an interpretation of CHX Article XX, Rule 7, which governs recognized quotations, because the Exchange believes that the provision is now obsolete. Specifically, the CHX seeks to delete an interpretation that prohibits specialists from disseminating automatically-generated quotations that are more than \$.10 away from the Intermarket Trading System ("ITS") best bid or offer. This prohibition extends to all Dual Trading System (*i.e.*, listed) issues.⁴

Like many exchanges, the CHX has a functionality, commonly referred to as the "auto-quote" functionality, which its specialists may use to generate

quotations automatically, based on the best bid or offer disseminated by another market. The auto-quote functionality typically is used by a CHX specialist to generate a quotation when there is no interest in the specialist's book that would be the basis for a quotation by the specialist.⁵ When the CHX specialist is in auto-quote mode, CHX Article XX, Rule 7, Interpretation and Policy .02 prohibits the specialist from disseminating automatically-generated quotations that are more than \$.10 away from ITS best bid or offer.⁶

Following the securities industry's transition to decimal pricing, the consolidated quotations in the national securities market "flicker" significantly throughout each trading day. Because the auto-quote functionality is based on a flickering quotation, quotations generated by the CHX auto-quote functionality correspondingly flicker, potentially resulting in confusion for order-sending firms (and even the specialist himself). Accordingly, the CHX believes that it is appropriate to remove the interpretation that mandates an auto-quote spread of \$.10 or less, so that the CHX specialist may utilize the auto-quote functionality (when necessary) to generate a wider or different quotation that will not be subject to incessant flickering.⁷

Significantly, the CHX believes that this change is not only appropriate, but is mandated given recent changes in the way that systems capacity is allocated and paid for in the listed markets. Today, under an amendment to the Consolidated Quotation Association ("CQA") plan, each listed exchange is required to estimate the systems capacity needs associated with such exchange's anticipated quotation traffic for a given time period. SIAC, as the securities information processor ("SIP") for the listed markets, then bills each exchange for the systems capacity used by such exchange in disseminating its quotations. To the extent that an exchange exceeds its capacity estimates, the CQA plan provides for potentially significant financial penalties. Excessive quotation traffic is thus not only

⁵ The specialist is required to disseminate a continuous two-sided market in all listed issues pursuant to the terms of the ITS plan. Auto-quoting is a tool that enables a CHX specialist to satisfy this requirement, even when there is no interest in the specialist's book upon which the specialist could base a quotation.

⁶ Prior to the securities industry transition to decimal pricing, the interpretation prohibited quotations of more than 1/8 of a point away from the ITS best bid or offer.

⁷ For example, the specialist might want to set his or her auto-quote functionality based on the quote in a particular market (such as the market with the tightest spreads).

³ See letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated November 25, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange expanded its discussion regarding the consequences of the proposed rule change, and also clarified that the proposed rule change was filed pursuant to section 19(b)(2) of the Act. 15 U.S.C. 78s(b)(2).

⁴ There is no corresponding provision in the CHX rules relating to auto-quoting in Nasdaq/NM securities.