

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55155; File No. SR-BSE-2006-49)

January 23, 2007

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

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”),¹ and Rule 19b-4 thereunder,² 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, 2006.³ 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.⁴ 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 54789 (November 20, 2006), 71 FR 68654.

⁴ 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.

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.⁵ In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,⁶ 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.

⁵ 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).

⁶ 15 U.S.C. 78f(b)(5).

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.⁷

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁸ 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.⁹

Florence E. Harmon
Deputy Secretary

⁷ 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).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).