

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51969; File No. SR-CBOE-2005-44)

July 5, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Amending Obvious Error Rules

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 June 14, 2005, the Chicago Board Options Exchange, Inc. (“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 prepared by the CBOE. The Exchange filed the proposed rule change as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act,³ which renders the proposal effective upon filing with the Commission. 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 CBOE proposes to revise its obvious error rules for equity and index options. Below is the text of the proposed rule change. Proposed deletions are in [brackets].

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

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Chicago Board Options Exchange, Incorporated

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Rule 6.25 Nullification and Adjustment of Equity Option Transactions

This Rule governs the nullification and adjustment of transactions involving equity options. Rule 24.16 governs the nullification and adjustment of transactions involving index options and options on ETFs and HOLDRs. Paragraphs (a)(1), and (2) of this Rule have no applicability to trades executed in open outcry.

(a) Trades Subject to Review

A member or person associated with a member may have a trade adjusted or nullified if, in addition to satisfying the procedural requirements of paragraph (b) below, one of the following conditions is satisfied:

- (1) No change
- (2) No Bid Series: Electronic transactions in series quoted no bid [at a nickel (*i.e.*, \$0.05 offer)] will be nullified provided at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid [at a nickel] at the time of execution.

(3) – (5) No change

(b) – (e) No change

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Rule 24.16 Nullification and Adjustment of Index Option Transactions

This Rule only governs the nullification and adjustment of transactions involving index options and options on ETFs or HLDRs. Rule 6.25 governs the nullification and adjustment of

transactions involving equity options. Paragraphs (a)(1), (2), (6) and (7) of this Rule have no applicability to trades executed in open outcry.

(a) Trades Subject to Review

A member or person associated with a member may have a trade adjusted or nullified if, in addition to satisfying the procedural requirements of paragraph (b) below, one of the following conditions is satisfied:

(1) – (6) No change

(7) No Bid Series: Electronic transactions in series quoted no bid [at a nickel (*i.e.*, \$0.05 offer)] will be nullified provided at least one strike price below (for calls) or above (for puts) in the same options class was quoted no bid [at a nickel] at the time of execution.

(b) – (e) No change

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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 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. The 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, Proposed Rule Change

1. Purpose

The CBOE proposes to revise its obvious error rules with respect to equities and indexes (CBOE Rules 6.25 and 24.16, respectively) ("Obvious Error Rules") to adjust the terms that relate to the nullification of no bid series as set forth in CBOE Rules 6.25(a)(2) and 24.16(a)(7) (together "No Bid Provisions").

Under the current No Bid Provisions, electronic transactions in option series quoted no bid at a nickel (*i.e.*, \$0.05 offer) are nullified provided at least one strike price below (for calls) or above (for puts) in the same options class is quoted no bid at a nickel at the time of execution. A "no bid" option refers to an option where the bid price is \$0.00.⁴ Series of options quoted no bid are usually deep out-of-the-money series that are perceived as having little if any chance of expiring in-the-money.⁵ For this reason, relatively few transactions occur in these series, and those that do are usually the result of a momentary pricing error. In some cases, the pricing error is substantial enough such that other provisions in the Obvious Error Rules become applicable. The Exchange asserts that in many cases though, the No Bid Provisions are the only provisions that would apply to the pricing error.

The proposed rule change would remove the condition set forth in the No Bid Provisions that provides that the option series must be offered at a nickel and instead only require that the option series be quoted no bid. The Exchange states that the reason for this change is that

⁴ When the bid price is \$0.00, the offer price is typically \$0.05. In this instance, the option typically is referred to as "no bid at a nickel."

⁵ For example, on July 11th with the underlying stock trading at \$21, the JULY 40 calls likely will be quoted no-bid at a nickel.

options that are priced at no bid, regardless of the offer, are usually deep out-of-the-money series that are perceived as having little if any chance of expiring in-the-money. This is especially the case when the series below (for calls) or above (for puts) in the same option class similarly is quoted no bid. In this regard, the offer price is irrelevant. Therefore, transactions that are no bid at a dime, for example, are just as likely to be the result of an obvious error as are transactions that are no bid at a nickel when the series below (for calls) or above (for puts) in the same option class similarly is quoted no bid. The Exchange also notes that the text of the No Bid Provisions, as proposed, is substantively identical to Rule 1092(c)(ii)(E) of the Philadelphia Stock Exchange (“Phlx”) Rulebook, which applies to options on stocks, exchange-traded fund shares, and foreign currencies.

2. Statutory Basis

The CBOE believes that the filing provides for the nullification of certain trades that result from an inaccurate pricing anomaly. For this reason, and because the same provision has already been approved for the Phlx,⁶ the Exchange believes that its proposal is consistent with Section 6(b) of the Act⁷ in general, and furthers the objectives of Section 6(b)(5) of the Act⁸ in particular, in that it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and national market system and, in general, to protect investors and the public interest.

⁶ See Securities Exchange Act Release No. 49785 (May 28, 2004), 69 FR 32090 (June 8, 2004) (Order approving adoption of Phlx Rule 1092(c)(ii)(E)).

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

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

The CBOE does not believe that the proposed rule change will impose any inappropriate burden on competition 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

The CBOE neither solicited nor received written comments on the proposed rule change.

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

Because the proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of filing (or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest), the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁹ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁰ As required under Rule 19b-4(f)(6)(iii),¹¹ the Exchange provided the Commission with 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 the filing of the proposed rule change.

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.¹² However, Rule 19b-4(f)(6)(iii)¹³ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. In addition, the Exchange has requested that the Commission waive the 30-day operative

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6).

¹¹ 17 CFR 240.19b-4(f)(6)(iii).

¹² Id.

¹³ Id.

delay and render the proposed rule change to become operative immediately. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Waiver of the 30-day operative delay would enable the Exchange to implement the proposal as quickly as possible. In addition, the Commission notes that the proposed No Bid Provisions are substantially identical to Phlx Rule 1092(c)(ii)(E). The Commission does not believe that the proposed rule change raises new regulatory issues. For the reasons stated above, the Commission designates the proposal to become operative immediately.¹⁴

At any time within 60 days of the filing of the 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 the furtherance of the purposes of the Act.

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. Please include File Number SR-CBOE-2005-44 on the subject line.

¹⁴ For purposes of waiving the operative date of this proposal only, the Commission has considered the impact of the proposed rule on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9309.

All submissions should refer to File Number SR-CBOE-2005-44. 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. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2005-44 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 authority.¹⁵

Jill M. Peterson
Assistant Secretary

¹⁵ 17 CFR 200.30-3(a)(12).