

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52860; File No. SR-CBOE-2005-100)

November 30, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Obligations of Designated Primary Market Makers During the Implementation of the PAR Official Program

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> notice is hereby given that on November 22, 2005, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) 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 Exchange. CBOE has designated this proposal as non-controversial under Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposed rule change 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 Exchange proposes to issue a regulatory circular that will subject certain Designated Primary Market Makers (“DPMs”) to obligations that were removed upon the approval of the Exchange’s PAR Official proposal.<sup>5</sup> The text of the proposed regulatory circular is attached hereto as Exhibit A.

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<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)(iii).

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

<sup>5</sup> See infra note 6 and accompanying text.

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 Exchange 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 Exchange 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

On November 18, 2005, the Commission approved CBOE's proposal to remove a DPM's obligation to execute orders as an agent, including as a floor broker, in its allocated securities on the Exchange in any trading station and to allow the Exchange to appoint an Exchange employee or independent contractor ("PAR Official") to assume many of the functions and obligations that DPMs previously held ("PAR Official proposal").<sup>6</sup> A specific provision of rules approved in connection with the PAR Official proposal gives the Exchange up to ninety days to implement the PAR Official proposal.<sup>7</sup> Because this ninety-day implementation provision could mean that some DPMs will continue to be required to represent orders as agents in their allocated securities, those DPMs must still be subject to the same obligations that governed DPM operations prior to the approval of the PAR Official proposal. As such, the Exchange has incorporated those obligations into a regulatory circular that will govern the operations of those DPMs that were not immediately included in the PAR Official conversion as of November 18,

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<sup>6</sup> See Securities Exchange Act Release No. 52798 (November 18, 2005), 70 FR 71344 (November 28, 2005).

<sup>7</sup> See Interpretation and Policy .01 to CBOE Rule 7.12.

2005. These rules and obligations, as provided in the regulatory circular attached hereto as Exhibit A, were adopted directly from the now-former DPM rules.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)<sup>8</sup> of the Act in general, and furthers the objectives of Section 6(b)(5)<sup>9</sup> in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public interest.

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

The Exchange 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.

### 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

The foregoing proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and Rule 19b-4(f)(6) thereunder<sup>11</sup> because the proposed rule change does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; or (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. In addition, the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

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 as required by Rule 19b-4(f)(6).<sup>12</sup>

Pursuant to Rule 19b-4(f)(6)(iii) under the Act,<sup>13</sup> the proposal does not become operative until 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay so that the proposed rule change becomes effective immediately. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. The Commission notes that granting this waiver will ensure that DPMs not immediately subject to the new rules approved recently in connection with the PAR Official proposal will continue to be subject to appropriate regulation. Therefore, the Commission has determined to waive the 30-day delay and to allow the proposed rule change to become operative immediately.<sup>14</sup>

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 furtherance of the purposes of the Act.<sup>15</sup>

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<sup>12</sup>

Id.

<sup>13</sup>

17 CFR 240.19b-4(f)(6)(iii).

<sup>14</sup>

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

<sup>15</sup>

15 U.S.C. 78s(b)(3)(C).

#### 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 No. SR-CBOE-2005-100 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2005-100. 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 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-2005-100 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

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

Jonathan G. Katz  
Secretary

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<sup>16</sup> 17 CFR 200.30-3(a)(12).

Exhibit A

Chicago Board Options Exchange, Incorporated

Regulatory Circular RG05-xx

DATE: November 18, 2005  
TO: Members and Member Firms  
FROM: Legal Division; Regulatory Division; Trading Operations Division  
RE: DPM Obligations Until the Implementation of the PAR Official Program

On November 18, 2005, the Securities and Exchange Commission (“SEC”) approved a CBOE rule change, SR-CBOE-2005-46 (“rule change” or “PAR Official rule change”), that, among other things, (1) prohibits a DPM from executing orders as an agent or Floor Broker in its allocated option classes and (2) eliminates the authority of a DPM to act in any other way as a Floor Broker in those classes.<sup>1</sup> Rule 8.8 and Rule 8.85(b) now prevent a DPM from representing or executing orders for other persons in the DPM’s assigned option classes. Once the rule change goes into effect in a particular options class, the DPM assigned to that option class will lose the ability to take custody of or handle orders for other persons in that option class, including through operation of the PAR terminal. The rule change authorizes the Exchange to assign to an Exchange employee or subcontractor known as a PAR Official, the responsibility, among other things, to operate the PAR workstation for designated option classes, to maintain the book in those classes, to represent orders to be sent via Intermarket Option Linkage in those classes, and to effect executions of agency orders placed with the PAR Official in those classes.

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<sup>1</sup> Please refer to the rule change and the SEC order approving the rule change, which both can be found on the Exchange’s website at <http://www.cboe.org/Legal/filings.aspx>.

The rule change allows the Exchange to put PAR Officials in place in DPM trading crowds during a 90-day period after the SEC approves the rule change. This provision is intended to insure a smooth roll-out of the PAR Official program. Therefore, until a PAR Official is put in place in a particular DPM trading crowd during this 90-day transition period, the DPM in that trading crowd will continue to be responsible to operate the PAR workstation and will continue to be subject to the same agency obligations as set forth under former Rule 8.85(b) and to other obligations applicable to DPMs under current and former Exchange rules. These rules and regulations are provided below:

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#### DPM Obligations

(a) General Obligations. Each DPM shall fulfill all of the obligations of a Floor Broker or Order Book Official (to the extent that the DPM acts as a Floor Broker) under the Rules, and shall satisfy each of the requirements contained in this paragraph, in respect of each of the securities allocated to the DPM. To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b) through (i) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b) through (i) of this Rule shall govern.

(b) Display Obligation: Each DPM shall display immediately the full price and size of any customer limit order that improves the price or increases the size of the best disseminated CBOE quote. “Immediately” means, under normal market conditions, as soon as practicable but no later than 30-seconds after receipt (“30-second standard”) by the DPM. The term “customer limit order” means an order to buy or sell a listed option at a specified price that is not for the account of either a broker or dealer; provided, however, that the term customer limit order shall

include an order transmitted by a broker or dealer on behalf of a customer. The following are exempt from the Display Obligation as set forth under this provision:

- (A) An order executed upon receipt;
  - (B) An order where the customer who placed it requests that it not be displayed, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were subject to being displayed;
  - (C) An order for which immediately upon receipt a related order for the principal account of a DPM reflecting the terms of the customer order is routed to another options exchange that is a participant in the Intermarket Options Linkage Plan;
  - (D) The following orders as defined in Rule 6.53: contingency orders; one-cancels-the-other orders; all or none orders; fill or kill orders; immediate or cancel orders; complex orders (e.g., spreads, straddles, combinations); and stock-option orders;
  - (E) Orders received before or during a trading rotation (as defined in Rule 6.2, 6.2A, and 6.2B), including Opening Rotation Orders as defined in Rule 6.53(l), are exempt from the 30-second standard, however, they must be displayed immediately upon conclusion of the applicable rotation; and
  - (F) Large Sized Orders: Orders for more than 100 contracts, unless the customer placing such order requests that the order be displayed.
- (c) A DPM shall not remove from the public order book any order placed in the book unless (A) the order is canceled, expires, or is executed or (B) the DPM returns the order to the member that placed the order with the DPM in response to a request from that member to return the order;

(d) A DPM shall accord priority to any customer order which the DPM represents as agent over the DPM's principal transactions, unless the customer who placed the order has consented to not being accorded such priority;

(e) A DPM shall not charge any brokerage commission with respect to:

(1) the execution of any portion of an order for which the DPM has acted as both agent and principal, unless the customer who placed the order has consented to paying a brokerage commission to the DPM with respect to the DPM's execution of the order while acting as both agent and principal; or

(2) any portion of an order for which the DPM was not the executing floor broker, including any portion of the order that is automatically executed through an Exchange system; or

(3) any portion of an order that is automatically cancelled, or;

(4) any portion of an order that is not executed and not cancelled.

(f) A DPM shall act as a Floor Broker to the extent required by the MTS Committee.

(g) A DPM shall not represent discretionary orders as a Floor Broker or otherwise.

(h) Autobook Pilot. A DPM shall maintain and keep active on the DPM's PAR workstation at all times the automated limit order display facility ("Autobook") provided by the Exchange. The appropriate Exchange Floor Procedure Committee will determine the Autobook timer in all classes under that Committee's jurisdiction. A DPM may deactivate Autobook as to a class or classes provided that Floor Official approval is obtained. The DPM must obtain such approval no later than three minutes after deactivation.

(i) The Exchange may make personnel available to assist a DPM in the DPM's performance of the obligations of an Order Book Official, for which the Exchange may charge the DPM a reasonable fee.

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#### RAES Operations

DPMs will still be responsible for non-automated handling of orders routed to the PAR workstation pursuant to Rule 6.8(d)(vi) and Interpretation and Policy .02(b) of Rule 6.8.

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#### Priority of Bids and Offers and Priority of Allocation of Trades

DPMs shall be required to comply with those provisions of Rule 6.45, 6.45A, and 6.45B, that are now assigned to PAR Officials.

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#### Timing of Firm Quote Obligations in a DPM Trading Crowd With Respect to Firm Disseminated Market Quotes

In Non-Hybrid classes, for purposes of determining when the firm quote obligations under Rule 8.51 attach in respect of orders received at a PAR workstation in a DPM trading crowd and how the exemptions to that obligation provided in paragraph (e) of that Rule apply, the responsible broker or dealer shall be deemed to receive an order, and an order shall be deemed to be presented to the responsible broker or dealer, at the time the order is received on the DPM's PAR workstation.

In Hybrid classes, for purposes of determining when the firm quote obligations under Rule 8.51 attach with respect to orders received at a PAR workstation in a DPM trading crowd and how the exemptions to that obligation provided in paragraph (e) of that rule apply, the

responsible broker or dealer shall be deemed to receive an order, and an order shall be deemed presented to the responsible broker or dealer:

- (i) at the time the order is announced to the trading crowd with respect to each responsible broker or dealer that is not the DPM for the class; and
- (ii) at the time the order is received on PAR with respect to the DPM as the responsible broker or dealer.

As such, firm quote obligations for an order received on a PAR workstation may attach at two separate times for different responsible broker or dealers: at the time of receipt with respect to the DPM as a responsible broker or dealer and at the time of announcement with respect to non-DPM members of the trading crowd as responsible brokers or dealers.

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### Linkage Rules

Only with respect to any DPM continuing to represent and execute orders as agent pursuant to this Regulatory Circular, Rule 6.80 (“Definitions”) paragraph (12)(i) shall read as follows:

“Principal Acting as Agent (‘P/A’) Order,” which is an order for the principal account of a Market-Maker (or equivalent entity on another Participant Exchange that is authorized to represent Customer orders) reflecting the terms of a related unexecuted Customer order for which the Market-Maker is acting as agent.

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### DPM Designees

The DPM must continue to maintain the requisite number of approved DPM Designees, as defined under Rule 8.81. Additionally, these DPM Designees must continue to be registered

as a Floor Broker pursuant to Rule 6.71. A DPM Designee also shall continue to be restricted from trading as a Floor Broker in securities allocated to the DPM unless acting on behalf of the DPM in its capacity as a DPM.

Finally, when acting on behalf of a DPM in its capacity as a DPM, the DPM Designee is exempt from the provisions of Rule 8.8 (“Restriction on Acting as Market-Maker and Floor Broker”). (See former Rule 8.81(e)).

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#### Rule 17.50. Imposition of Fines for Minor Rule Violations

DPMs shall be subject to a fine for failure to promptly book and display limit orders that would improve the disseminated quote or for failure to use due diligence in the execution of orders for which the DPM maintains an agency obligation.

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#### Summary

After the rule change has been approved and until the end of the 90-day trading period, neither a DPM assigned to a trading crowd nor the Exchange shall be subject to the provisions of the rule change with respect to the operation of that trading crowd until a PAR Official has been assigned to that trading crowd.

Questions pertaining to this Regulatory Circular should be directed to Jim Flynn at (312) 786-7070; Doug Beck at (312) 786-7959; or John Johnston at (312) 786-7303.