

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52021; File No. SR-CBOE-2005-50)

July 13, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change to Modify the Designated Primary Market-Maker Participation Entitlement for Orders Specifying a Preferred DPM

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 29, 2005, 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 prepared by the CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. In addition, the Commission is granting accelerated approval of the proposed rule change.

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

The CBOE proposes to modify the Designated Primary Market-Maker (“DPM”) participation entitlement for orders specifying a Preferred DPM. Proposed new language is in italics; proposed deletions are in [brackets].

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Rule 8.87 Participation Entitlements of DPMs and e-DPMs

(a) Subject to the review of the Board of Directors, the MTS Committee may establish from time to time a participation entitlement formula that is applicable to all DPMs.

(b) The participation entitlement for DPMs and e-DPMs (as defined in Rule 8.92) shall operate as follows:

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(1) Generally.

(i) To be entitled to a participation entitlement, the DPM/e-DPM must be quoting at the best bid/offer on the Exchange.

(ii) A DPM/e-DPM may not be allocated a total quantity greater than the quantity that the DPM/e-DPM is quoting at the best bid/offer on the Exchange.

(iii) The participation entitlement is based on the number of contracts remaining after all public customer orders in the book at the best bid/offer on the Exchange have been satisfied.

(2) Participation Rates applicable to DPM Complex. The collective DPM/e-DPM participation entitlement shall be: 50% when there is one Market-Maker also quoting at the best bid/offer on the Exchange; 40% when there are two Market-Makers also quoting at the best bid/offer on the Exchange; and, 30% when there are three or more Market-Makers also quoting at the best bid/offer on the Exchange.

(3) Allocation of Participation Entitlement Between DPMs and e-DPMs. The participation entitlement shall be as follows: If the DPM and one or more e-DPMs are quoting at the best bid/offer on the Exchange, the e-DPM participation entitlement shall be one-half (50%) of the total DPM/e-DPM entitlement and shall be divided equally by the number of e-DPMs quoting at the best bid/offer on the Exchange. The remaining half shall be allocated to the DPM. If the DPM is not quoting at the best bid/offer on the Exchange and one or more e-DPMs are quoting at the best bid/offer on the Exchange, then the e-DPMs shall be allocated the entire participation entitlement (divided equally between them). If no e-DPMs are quoting at the best bid/offer on the Exchange and the DPM is quoting at the best bid/offer on the Exchange, then the DPM shall be allocated

the entire participation entitlement. If only the DPM and/or e-DPMs are quoting at the best bid/offer on the Exchange (with no Market-Makers at that price), the participation entitlement shall not be applicable and the allocation procedures under Rule 6.45A shall apply.

(4) Allocation of Participation Entitlement Between DPMs and e-DPMs for Orders

Specifying a Preferred DPM. Notwithstanding the provisions of subparagraph (b)(3) above, the Exchange may allow, on a class-by-class basis, for the receipt of marketable orders, through the Exchange's Order Routing System when the Exchange's disseminated quote is the NBBO, that carry a designation from the member transmitting the order that specifies a DPM or e-DPM in that class as the "Preferred DPM" for that order.

In such cases and after the provisions of subparagraph (b)(1)(i) and (iii) above have been met, then the Preferred DPM participation entitlement shall be 50% when there is one Market-Maker also quoting at the best bid/offer on the Exchange; and 40% when there are two or more Market-Makers also quoting at the best bid/offer on the Exchange[; and, 30% when there are three or more Market-Makers also quoting at the best bid/offer on the Exchange], subject to the following:

(i) if the Preferred DPM is not quoting at the best bid/offer on the Exchange then the participation entitlement set forth in subparagraph (b)(3) above shall apply;

and

(ii) in no case shall the Preferred DPM be allocated, pursuant to this participation right, a total quantity greater than the quantity that the Preferred DPM is quoting at the best bid/offer on the Exchange.

The Preferred DPM participation entitlement set forth in subparagraph (b)(4) of this Rule shall be in effect until June 2, 2006 on a pilot basis.

...Interpretations and Policies:

.01 Notwithstanding subparagraph (b)(2) above, the Exchange may establish a lower DPM Complex Participation Rate on a product-by-product basis for newly-listed products or products that are being allocated to a DPM trading crowd for the first time. Notification of such lower participation rate shall be provided to members through a Regulatory Circular.

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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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it had received on the proposed rule change. The text of these statements may be examined at the places specified in Item III 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

CBOE Rule 8.87 governs the participation entitlement of DPMs and e-DPMs (the "DPM Complex"). CBOE Rule 8.87(b)(2) states the actual participation entitlement percentages applicable to the DPM Complex, which are tiered to take into account the number of non-DPM Market-Makers also quoting at the best price. The current participation entitlement percentages are as follows: 50% when there is one Market-Maker also quoting at the best bid/offer on the Exchange; 40% when there are two Market-Makers also quoting at the best bid/offer on the

Exchange; and 30% when there are three or more Market-Makers also quoting at the best bid/offer on the Exchange.

The CBOE recently obtained approval of a filing adopting a Preferred DPM Program (“Program”).³ A modification to the applicable participation entitlement percentages under the Program was also recently effected.⁴ Under the current Program, order providers can send an order to the Exchange designating a “Preferred DPM” from among the DPM Complex. If the Preferred DPM is quoting at the National Best Bid or Offer (“NBBO”) at the time the order is received on the CBOE, the Preferred DPM is entitled to the entire participation entitlement described above. The Philadelphia Stock Exchange (“Phlx”) recently obtained approval of a directed order program that allows the directed order recipient to receive a 40% participation entitlement on designated orders received while that entity is quoting at the NBBO.⁵ The International Securities (“ISE”) also recently obtained approval to implement a preferencing program that allows a preferenced ISE market maker to receive a 40% participation entitlement on designated orders received while that market maker is quoting at the NBBO.⁶ According to the CBOE, the purpose of this filing is to match the participation rate of the Phlx directed order program and the ISE preferencing program.

³ See Securities Exchange Act Release No. 51779 (June 2, 2005), 70 FR 33564 (June 8, 2005) (order approving SR-CBOE-2004-71).

⁴ See Securities Exchange Act Release No. 51824 (June 10, 2005), 70 FR 35476 (June 20, 2005) (notice of filing and immediate effectiveness of File No. SR-CBOE-2005-45).

⁵ See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (order approving SR-Phlx-2004-91).

⁶ See Securities Exchange Act Release No. 51818 (June 10, 2005), 70 FR 35146 (June 16, 2005) (order approving SR-ISE-2005-18).

In cases in which the Preferred DPM is quoting at the NBBO at the time the order is received on the CBOE, this proposal increases the participation entitlement for a Preferred DPM to 40% from 30% when there are two or more Market-Makers also quoting at the NBBO.⁷ The proposal does not modify the participation entitlement for orders that do not specify a Preferred DPM. The CBOE notes that the Preferred DPM Program is operating on a one-year pilot basis.

2. Statutory Basis

The CBOE believes the proposed rule change is consistent with Section 6(b) of the Act,⁸ in general, and furthers the objectives of Section 6(b)(5),⁹ in particular, 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

The CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in the 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.

⁷ Telephone conversation between John Roeser, Assistant Director, David Hsu, Special Counsel, Theodore Venuti, Attorney, Division of Market Regulation, Commission, and Angelo Evangelou, Senior Managing Attorney, CBOE, on July 6, 2005.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

III. 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-2005-50 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-2005-50. 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, 100 F Street, NE, Washington, DC 20549. 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 publicly available. All submissions should refer to File Number SR-CBOE-2005-50 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder, applicable to a national securities exchange.¹⁰ In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹¹ which requires among other things, that the rules of the Exchange are 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 notes that the Preferred DPM Program currently operates on a one-year pilot basis.¹² The proposal would increase the participation entitlement percentage for a Preferred DPM when there are two or more Market-Makers also quoting at the NBBO. Because the proposal would not increase the participation entitlement beyond the currently acceptable threshold, the Commission does not believe that the proposal will negatively impact quote competition on the CBOE.¹³ In

¹⁰ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹¹ 15 U.S.C. 78f(b)(5).

¹² See supra note 3. The CBOE subsequently modified the amount of the participation entitlement allocable to the Preferred Market-Maker. See supra note 4.

¹³ See supra note 5.

addition, the Commission notes that it has approved similar participation entitlements percentages on other options exchanges.¹⁴

The CBOE has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register. The Commission believes that granting accelerated approval of the proposal should allow the CBOE to immediately implement the participation entitlement percentage for a Preferred DPM similar to the percentage already in place on the Phlx and the ISE. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,¹⁵ for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register.

¹⁴ See supra notes 5 and 6.

¹⁵ 15 U.S.C. 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule change (SR-CBOE-2005-50) be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Jill M. Peterson
Assistant Secretary

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 17 CFR 200.30-3(a)(12).