

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54216; File No. SR-CBOE-2006-58)

July 26, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Regarding DPM and e-DPM Membership Ownership Requirements and the Ultimate Matching Algorithm

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 14, 2006, the Chicago Board Options Exchange, Incorporated (“CBOE” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. The CBOE filed Amendment No. 1 to the proposed rule change on July 18, 2006.³ 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

CBOE proposes to amend CBOE Rules relating to membership ownership requirements. CBOE also proposes to amend the provisions of CBOE Rules 6.45A and 6.45B which provide that a DPM or Lead Market Maker (“LMM”) utilizing more than one membership in the trading crowd where a class is traded will count as two market participants for purposes of Component A of the Ultimate Matching Algorithm (“UMA”).

The text of the proposed rule change is available on the Exchange’s Web site

(<http://www.cboe.com>), at the Office of the Secretary, CBOE and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced and superseded the original filing in its entirety.

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 those 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 parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

CBOE Rules 8.85 and 8.92 require that a DPM organization and e-DPM organization, respectively, own a certain number of Exchange memberships. Specifically, with respect to DPM organizations, CBOE Rule 8.85 requires that each DPM organization own one Exchange membership for each trading location at which the organization serves as a DPM. CBOE Rule 8.92 requires that until July 12, 2007, each e-DPM organization is required to own one Exchange membership for every 30 products allocated to the e-DPM, or lease one Exchange membership for every 20 products allocated to the e-DPM.⁴

CBOE proposes to modify these membership ownership requirements in connection with the Exchange's determination to apply a specific "appointment cost" to each options class allocated to a DPM organization or an e-DPM organization. With respect to DPM organizations, CBOE Rule 8.85, as proposed to be amended, would require that each DPM organization own one Exchange membership, and own or lease such additional Exchange memberships as may be necessary based on the aggregate "appointment cost" for the classes

⁴ After July 12, 2007, each e-DPM organization is required to own one Exchange membership for every 30 products allocated to the e-DPM.

allocated to the DPM organization. Each membership owned or leased by the DPM organization would have an appointment credit of 1.0. The appointment costs for the Hybrid 2.0 Option Classes and the Non-Hybrid Classes allocated to the DPM organization would be the same as the appointment costs set forth in CBOE Rule 8.3. The appointment cost for Hybrid Option Classes would be .01 per class.

For example, if the DPM organization has been allocated such number of options classes that its aggregate appointment cost is 1.6, the DPM organization would be required to own at least one Exchange membership, and own or lease one additional Exchange membership. As it currently does for purposes of Remote Market Maker (“RMMs”) and Market-Maker appointments, the Exchange would rebalance the “tiers” set forth in proposed CBOE Rule 8.3(c)(i), excluding the “AA” and “A+” tiers, once each calendar quarter, which could result in additions or deletions to their composition. When a class changes “tiers” it would be assigned the “appointment cost” of that tier. Upon rebalancing, each DPM organization would be required to own or lease the appropriate number of Exchange memberships reflecting the revised “appointment costs” of the classes that have been allocated to it. CBOE Rule 8.85 also would provide that a DPM organization is required to own or lease the appropriate number of Exchange memberships at the time a new options class allocated to it pursuant to CBOE Rule 8.95 begins trading.

Additionally, because member organizations may be approved and function in a number of capacities at CBOE, including as a DPM organization, e-DPM organization, and as an RMM, CBOE proposes to allow the DPM organization to use any excess membership capacity in its capacity as an RMM or e-DPM. Specifically, in the event the member organization approved as the DPM organization is also approved to act as an RMM and/or e-

DPM, and has excess membership capacity above the aggregate appointment cost for the classes allocated to it as the DPM, the member organization would be permitted to utilize the excess membership capacity to quote electronically in an appropriate number of Hybrid 2.0 Classes in the capacity of an RMM and not trade in open outcry, or to quote electronically in the Hybrid 2.0 Classes in which it is appointed an e-DPM. For example, if the DPM organization has been allocated such number of option classes that its aggregate appointment cost is 1.6, the member organization could request an appointment as an RMM in any combination of Hybrid 2.0 Classes whose aggregate “appointment cost” does not exceed .40. The member organization would not function as a DPM in any of these additional classes. In the event the member organization utilizes any excess membership capacity to quote electronically in some additional Hybrid 2.0 Classes as an RMM or e-DPM, it would be required to comply with the provisions of CBOE Rules 8.4(c) and Rule 8.93(vii), respectively.

With respect to e-DPMs, CBOE Rule 8.92, as proposed to be amended, would require that each e-DPM organization own one Exchange membership, and own or lease such additional Exchange memberships as may be necessary based on the aggregate “appointment cost” for the classes allocated to the e-DPM organization. Each membership owned or leased by the e-DPM organization would have an appointment credit of 1.0. The appointment costs per Hybrid 2.0 Class, which are categorized by “tiers”, would be identical to the tiers and appointment costs set forth in CBOE Rules 8.3(c)(i) and 8.4(d) that have been structured for purposes of RMMs and Market Maker appointments.

If the e-DPM organization has been allocated such number of option classes that its aggregate appointment cost is 6.6, the e-DPM organization would be required to own at least

one Exchange membership, and own or lease six additional Exchange memberships. The Exchange would rebalance the “tiers” (excluding the “AA” and “A+” tiers) once each calendar quarter, which could result in additions or deletions to their composition. When a class changes “tiers” it would be assigned the “appointment cost” of that tier. Upon rebalancing, each e-DPM organization would be required to own or lease the appropriate number of Exchange memberships reflecting the revised “appointment costs” of the classes that have been allocated to it.

Similar to DPM organizations, CBOE proposes that in the event the member organization approved as the e-DPM organization is also approved to act as an RMM and/or DPM, and has excess membership capacity above the aggregate appointment cost for the classes allocated to it as the e-DPM, the member organization would be permitted to utilize the excess membership capacity to quote electronically in of Hybrid 2.0 Classes in the capacity of a RMM and not trade in open outcry, and/or to quote electronically and trade in open outcry in the classes in which it is appointed a DPM. For example, if the member organization has been allocated such number of option classes that its aggregate appointment cost is 6.6, the member organization could request an appointment as an RMM in any combination of Hybrid 2.0 Classes whose aggregate “appointment cost” did not exceed .40. The member organization would not function as an e-DPM in any of these additional classes. In the event the member organization utilizes any excess membership capacity to quote electronically in some additional Hybrid 2.0 Classes as an RMM or DPM, it would be required to comply with the provisions of CBOE Rules 8.4(c) and 8.85(a)(v), respectively. In connection with this change, CBOE proposes to delete the restriction in CBOE Rule 8.92

which states that memberships used to satisfy the membership ownership requirements may not be used to comply with the DPM membership ownership requirement of Rule 8.85(e).

Finally, CBOE proposes to amend the provisions of CBOE Rules 6.45A for DPMs and 6.45B for DPMs and LMMs, which provide that a DPM or LMM utilizing more than one membership in the trading crowd where a class is traded shall count as two market participants for purposes of Component A of UMA. Because each membership owned or leased by a DPM (or LMM) would now have an appointment credit of 1.0, and because each class in which a DPM (or LMM) has an appointment would have a specific appointment cost associated with it, CBOE does not believe that requiring a DPM (or LMM) to utilize a full membership to count as two market participants for purposes of Component A of UMA is reasonable. Rather, CBOE believes that it is more appropriate and reasonable to require that a DPM (or LMM) exclusively use the portion of a membership(s) representing one-half the total appointment cost of the classes allocated to the DPM (or, in which the LMM has been appointed) at a particular trading station in order to count as two market participants, and not for any other purpose.

For example, if a DPM's appointment cost is 2.2 for the classes allocated to it at a particular trading station, pursuant to proposed amendments to CBOE Rule 8.85(e), the DPM would be required to own one membership and own or lease two additional memberships. In addition, the DPM would be permitted to choose to count as two market participants for purposes of Component A of the Algorithm if the DPM exclusively utilizes 1.1 (one-half of 2.2) of the membership(s) it owns or leases in order to count as two market participants, and not utilize the 1.1 of the memberships for any other purpose. In this example, to comply with the membership ownership requirements and to count as two market participants for purposes

of Component A, the DPM would be required to own one membership, and own or lease three additional memberships to satisfy its total cost of 3.3 (2.2 + 1.1).

In amending CBOE Rules 6.45A and 6.45B, CBOE proposes to make it optional for a DPM (or LMM) to choose whether to exclusively use the portion of its membership(s) representing one-half the total appointment cost of the classes allocated to the DPM at a particular trading station in order to count as two market participants, or instead to use the excess membership capacity to quote electronically in Hybrid 2.0 Classes.

2. Statutory Basis

CBOE believes the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.⁵ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁶ requirements that the rules of an exchange be designed to remove impediments to and perfect the mechanism for 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

CBOE 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

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2006-58 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2006-58. 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-2006-58 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.⁷

Nancy M. Morris
Secretary

⁷ 17 CFR 200.30-3(a)(12).