

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50007; File No. SR-CBOE-2004-43)

July 13, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Incorporated to Amend the Exchange's Membership Rules to Accommodate e-DPMs

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 July 12, 2004, 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, II, and III below, which Items have been prepared by the CBOE. On July 12, 2004, the CBOE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The CBOE proposes to amend its Chapter III membership rules to accommodate the proposed creation of a new category of CBOE market-making participant - electronic Designated Primary Market-Makers ("e-DPMs").

Below is the text of the proposed rule change, as amended. Proposed new language is italicized; proposed deletions are in brackets.

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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> See letter from David Doherty, Attorney, Legal Division, CBOE, to Deborah Flynn, Assistant Director, Division of Market Regulation, Commission, dated July 12, 2004 ("Amendment No. 1"). In Amendment No. 1, the CBOE proposes to amend its original 19b-4 filing to remove the following sentence from Section 3 and Item II(A) of Exhibit I: "The individual designated may also be a nominee of one of the organization's other memberships."

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**Chicago Board Options Exchange, Incorporated**

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**Rules**

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**Rule 3.2 Qualifications and Membership Statuses of Individual Members**

(a) – (b) No change

(c) Every individual member who is a lessee, a Chicago Board of Trade exerciser, or an owner (who is not a lessor) must have an authorized trading [floor] function. An individual member is deemed to have an authorized trading [floor] function if the member is approved by the Membership Committee to act as a Market-Maker, [and/or] Floor Broker, or nominee or person registered for an e-DPM organization.

**. . . Interpretations and Policies**

.01 No change

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**Rule 3.8 Nominees and Members Who Register Their Memberships For Member Organizations**

(a) Each member organization that is the owner of a membership for which the member organization will not be acting as a lessor and each member organization that is a lessee of a membership shall be subject to the following provisions:

(i) No change

(ii) if the member organization is the owner or lessee of more than one such membership, the organization must designate a different individual to be the nominee for each of the memberships (except that this subparagraph shall not apply to memberships designated

for use in an e-DPM capacity pursuant to Rule 8.92 by a member organization approved as an e-DPM);

(iii) each nominee of a member organization designated pursuant to subparagraph (a)(i) of this Rule is required to have an authorized trading [floor] function, except that a nominee of a member organization that is approved solely to transact business with the public pursuant to Rule 9.1 is not required to comply with this requirement;

(iv) - (v) No change

(b) Each member organization that is the owner of a membership for which the member organization will be acting as a lessor shall be subject to the following provisions:

(i) - (ii) No change

(iii) the nominee of the member organization for the membership(s) with respect to which the organization will be acting as a lessor may not have an authorized trading [floor] function with respect to such membership(s);

(iv) the nominee of the member organization for the membership(s) with respect to which the organization will be acting as a lessor must satisfy all of the qualification requirements for membership, except for those requirements that are not applicable to lessors or that are applicable solely to members who will have an authorized trading [floor] function; and

(v) No change

(c) Each individual member who owns a membership and each Chicago Board of Trade exerciser may apply to register his or her membership for a member organization. Upon approval of such an application, an individual who has registered his or her membership for a member organization shall represent the organization in all matters relating to the Exchange in the same

manner that a nominee represents a member organization. Each individual who registers his or her membership for a member organization must have an authorized trading [floor] function.

(d) No change

(e) The following requirements shall apply to every nominee of a member organization and to every individual who has registered his or her membership for a member organization:

(i) No change

(ii) the person may have authorized trading [floor] functions only on behalf of one member organization; and

(iii) the person may perform trading [floor] functions only on behalf of the member organization for which the person is approved by the Exchange to perform such functions and may not perform trading [floor] functions on the person's own behalf or on behalf of another member organization.

(f) Notwithstanding the provisions of subparagraph (e)(iii) of this Rule, a nominee or person who has registered his or her membership for a member organization may act as an independent Market-Maker and/or an independent Floor Broker if the following 4 requirements are satisfied:

(A) the person obtains the prior written approval to do so, in a manner and form prescribed by the Exchange, from the member organization for which the person is approved by the Exchange to perform trading [floor] functions;

(B) the member organization for which the person is approved by the Exchange to perform trading [floor] functions agrees, in a manner and form prescribed by the Exchange, to guarantee all obligations arising out of that person's activities as an independent Market-Maker and/or an independent Floor Broker;

(C) - (D) No change

A person who is approved to act as an independent Market-Maker and/or an independent Floor Broker pursuant to this paragraph (f) shall be personally responsible for all obligations arising out of those activities, and the member organization for which the person is approved by the Exchange to perform trading [floor] functions shall guarantee these obligations.

(g) A member organization may designate one or more inactive nominees. An “inactive nominee” of a member organization is an individual who is eligible to become an effective nominee of that organization with respect to any membership for which the organization is either an owner (and not a lessor) or is a lessee. The following requirements shall apply to inactive nominees:

(i) to become an inactive nominee of a member organization, an individual must be approved for membership and become an effective nominee of the member organization, with authorized trading [floor] functions, within 90 days of the approval for membership;

(ii) - (iv) No change

### **. . . Interpretations and Policies**

.01 No change.

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### **Rule 3.9 Application Procedures and Approval or Disapproval**

(a) - (f) No change.

(g) Any person applying pursuant to paragraph (a) of this Rule to have an authorized trading [floor] function is required to have completed [attended] the Exchange’s [New] Member Orientation Program and to have passed an [the] Exchange[’s] Trading [Floor] Member Qualification Exam. Additionally, any person who has completed [attended] the [New] Member Orientation Program and taken and passed the applicable Trading [Floor] Member Qualification Exam and who then does not possess an authorized trading [floor] function for more than 1 year

is required to complete [re-attend] the [New] Member Orientation Program and to re-pass the applicable Trading [Floor] Member Qualification Exam in order to once again become eligible to have an authorized trading [floor] function. A person must score 75% or better on the applicable Trading [Floor] Member Qualification Exam in order to pass the Exam. Any person who fails the applicable Trading [Floor] Member Qualification Exam must wait 30 days to re-take the Exam after failing the Exam for the first time, must wait 60 days to re-take the Exam after failing the Exam for the second time, and must wait 120 days to re-take the Exam after failing the Exam for a third or subsequent time. The Exchange may not waive any of the requirements set forth in this paragraph (g).

(h) - (l) No change.

**... Interpretations and Policies**

.01 - .02 No change.

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**Rule 3.28 [Reserved] Letter of Guarantee**

[Reserved] Each member with trading functions on the Exchange shall provide a letter of guarantee for the member's trading activities on the Exchange from a Clearing Member in a form and manner prescribed by the Exchange.

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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, the Proposed Rule Change

1. Purpose

On May 7, 2004, the Commission published for comment SR-CBOE-2004-24,<sup>4</sup> which rule filing proposes to add a new category of CBOE market-making participant – e-DPMs – to enhance the liquidity base of the CBOE’s Hybrid Trading System. e-DPMs are member organizations appointed to operate on the CBOE as competing Designated Primary Market-Makers in a broad number of option classes. e-DPMs act as specialists on the CBOE by entering bids and offers electronically from locations other than the trading crowds where the applicable option classes are traded, and are not required to have traders physically present in the trading crowd. To accommodate the new e-DPM category, the CBOE is proposing amendments to CBOE Membership Rules 3.2, 3.8, 3.9, and 3.28.

CBOE Rule 3.8(a)(ii) currently states that member organizations that own more than one membership must designate separate individuals for each of those memberships. In the context of electronic access and market-making, this requirement serves no useful purpose and, to the contrary, may negatively affect an e-DPM member organization’s operating structure by imposing upon it unnecessary expenses. To this end, the CBOE proposes to restrict application of this rule such that it will not apply to e-DPM member organizations. This will allow a member organization to designate one individual to be the nominee of the memberships that are designated for use in an e-DPM capacity.

CBOE Rules 3.2, 3.8, and 3.9 contain several references to “floor functions.” e-DPMs,

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<sup>4</sup> See Securities Exchange Act Release No. 49643 (April 30, 2004), 69 FR 25647.

when introduced, will have a trading function but not a floor function. For this reason, the CBOE proposes to eliminate the word “floor” and instead refer to “trading function.”

Additionally, the CBOE proposes to amend CBOE Rule 3.2 to make clear that a member is deemed to have an authorized “trading function” if the member is approved by the Membership Committee to act as a nominee or person registered for an e-DPM organization. This would ensure under CBOE Rule 3.9(g) that the e-DPM nominee completes the CBOE’s Member Orientation Program (as proposed to be renamed herein) and passes the CBOE’s Trading Member Qualification Exam (as proposed to be renamed herein).

CBOE Market-Makers and Designated Primary Market-Makers are required pursuant to CBOE Rule 8.5 to furnish the CBOE with a letter of guarantee from a clearing member. New proposed CBOE Rule 3.28 seeks to impose the same obligation upon e-DPMs.

## 2. Statutory Basis

The creation of a new Designated Primary Market-Maker category will expand the CBOE’s liquidity base and market-making possibilities on the Exchange while ensuring that the nominee of the e-DPM organization has passed the proper Exchange administered exams and completed the requisite orientation program. Accordingly, the proposed rule change, as amended, is consistent with Section 6(b) of the Act<sup>5</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>6</sup> in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.

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

<sup>6</sup> 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 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

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

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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-43 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and

Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-43. 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, 450 Fifth Street, NW, 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 available publicly. All submissions

should refer to File Number SR-CBOE-2004-43 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.<sup>7</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).