

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50548; File No. SR-CBOE-2004-25)

October 15, 2004

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Incorporated Relating to Designated Primary Market-Makers Obligations

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 April 23, 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 September 30, 2004, the CBOE filed Amendment No. 1 to the proposed rule change.³ 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 rules to clarify that CBOE Designated Primary Market-Makers (“DPMs”) are required to make competitive markets on the Exchange and to otherwise promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the classes they trade.⁴

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaces and supercedes the CBOE’s original 19b-4 filing in its entirety.

⁴ Telephone conversation between James M. Flynn, Attorney, CBOE, and Sapna C. Patel, Special Counsel, and Angela Muehr, Attorney, Division of Market Regulation,

CHAPTER VIII

Market-Makers, Trading Crowds and Modified Trading Systems (Rules 8.1 – 8.95)

Rule 8.85 – DPM Obligations

Rule 8.85 (a) – (b) No Change

(c) Other Obligations. In addition to the obligations described in paragraphs (a) and (b) of this Rule, a DPM shall fulfill each of the following obligations:

(i) resolve disputes relating to transactions in the securities allocated to the DPM, subject to Floor Official review, upon the request of any party to the dispute;

(ii) make competitive markets on the Exchange and otherwise promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the classes it trades [provide high quality markets and services and promote the Exchange as a marketplace to customers and other market participants];

(iii) promptly inform the MTS Committee of any desired change in the DPM Designees who represent the DPM in its capacity as a DPM and of any material change in the financial or operational condition of the DPM;

(iv) supervise all persons associated with the DPM to assure compliance with the Rules;

(v) segregate in a manner prescribed by the MTS Committee the DPM's business and activities as a DPM from the DPM's other businesses and activities; and

(vi) continue to act as a DPM and to fulfill all of the DPM's obligations as a DPM or the MTS Committee terminates the DPM's approval to act as a DPM pursuant to Rule 8.90.

(d) – (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, the Proposed Rule Change

1. Purpose

The Exchange proposes to amend its rules governing DPMs in order to create an obligation that would require a DPM to make competitive markets on the Exchange and otherwise to promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the classes it trades. This is identical to an obligation that is currently imposed on CBOE electronic DPMs (“e-DPMs”) under CBOE Rule 8.93(vi).⁵

This proposed rule language would replace an existing DPM obligation under CBOE Rule 8.85(c)(ii), that is more of a generalized statement of the e-DPM obligation. CBOE Rule 8.85(c)(ii) currently requires a DPM to commit to “provid[ing] high quality markets and services and promot[ing] the Exchange as a marketplace to customers and other market participants”

The Exchange believes that the proposed new language would provide a more specific statement

⁵ See Securities Exchange Act Release No. 50003 (July 12, 2004), 69 FR 43208 (July 19, 2004) (order approving e-DPMs on the Exchange).

of what is currently expected of a DPM.

Additionally, the CBOE represents that this proposed new language is consistent with the standards of measurement used by the Exchange in determining whether a DPM is meeting its overall market performance standards. CBOE Rule 8.88 (Review of DPM Operations and Performance) requires the Exchange’s Modified Trading System Appointments Committee (“MTS Committee”) to conduct an annual review of a DPM’s operations and performance. Under CBOE Rule 8.88, the review shall include an evaluation of how a DPM has acted to make the Exchange competitive with other markets trading the same securities as those allocated to the DPM, taking into account the Exchange’s market share in those allocated securities. In addition to making the DPM and e-DPM obligations more uniform, this proposal amends CBOE Rule 8.85(c) (Other Obligations) to expressly state that a DPM has the obligation to act to meet the levels of market performance that are currently expected of a DPM and that the MTS Committee currently considers when reviewing a DPM’s market performance.

2. Statutory Basis

By clarifying a DPM’s obligations and making them more consistent with the obligations required of e-DPMs, the Exchange believes that this proposed rule change, as amended, is consistent with Section 6(b) of the Act,⁶ in general, and further the objectives of Section 6(b)(5) of the Act,⁷ 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.

⁶ 15 U.S.C. 78f(b).

⁷ 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. Please include File Number SR-CBOE-2004-25 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-2004-25. 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-2004-25 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.⁸

Margaret H. McFarland
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).