

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51824; File No. SR-CBOE-2005-45)

June 10, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of 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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 6, 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 CBOE filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission.<sup>5</sup> 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 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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<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).

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

<sup>5</sup> The Exchange provided the Commission with written notice of its intention to file the proposed rule change on June 3, 2005. The Exchange has requested that the Commission waive the 30-day operative delay. 17 CFR 240.19b-4(f)(6)(iii).

**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) 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; 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, [participation entitlement applicable to the DPM Complex (as set forth in subparagraph (b)(2) above) shall be allocated to the Preferred DPM] subject to the following:

[(i) if the Preferred DPM is an e-DPM and the DPM is also quoting at the best bid/offer on the Exchange, then 2/3 of the participation entitlement shall be allocated to the Preferred DPM and the balance of the participation entitlement shall be allocated to the DPM;

(ii) if the Preferred DPM is an e-DPM and the DPM is not quoting at the best bid/offer on the Exchange but one or more e-DPMs are also quoting at the best bid/offer on the Exchange, then 2/3 of the participation entitlement shall be allocated to the Preferred DPM and the balance of the participation entitlement shall be divided equally between the remaining e-DPMs also quoting at the best bid/offer on the Exchange;

(iii) if the Preferred DPM is the DPM and one or more e-DPMs are also quoting at the best bid/offer on the Exchange, then 2/3 of the participation entitlement shall be allocated to the Preferred DPM and the balance of the participation entitlement shall be divided equally between the e-DPMs quoting at the best bid/offer on the Exchange;]

[(iv)] (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

[(v) if only members of the DPM Complex are quoting at the best bid/offer on the Exchange then the participation entitlement applicable to the Preferred DPM shall be: 50% when there is one other member of the DPM Complex also quoting at the best bid/offer on the Exchange; 40% when there are two other members of the DPM Complex quoting at the best bid/offer on the Exchange; and, 30% when

there are three or more members of the DPM Complex also quoting at the best bid/offer on the Exchange. The other members of the DPM Complex shall not receive a participation entitlement and the allocation procedures under Rule 6.45A shall apply; and]

[(vi)] (ii) in no case shall the Preferred DPM [a DPM/e-DPM] be allocated, pursuant to this participation right, a total quantity greater than the quantity that the Preferred DPM [DPM/e-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 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

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 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.<sup>6</sup> Under that 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 2/3 of the 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.<sup>7</sup> The purpose of this filing is to remain competitive with the Phlx directed order program.

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<sup>6</sup> See Securities Exchange Act Release No. 51779 (June 2, 2005) (order approving SR-CBOE-2004-71).

<sup>7</sup> See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (order approving SR-Phlx-2004-91).

This proposal increases the participation entitlement applicable to Preferred DPMs from 2/3 of the “regular” participation entitlement to the entire participation entitlement. Thus, the Preferred 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. The proposal does not in any way modify the percentage of an order that is available to non-DPM quoters while allowing the Exchange’s program to be more competitive with the Phlx directed order program. The CBOE notes that other exchanges have rules that provide specialist entitlements as high as 40% (with three or more market-makers also quoting at the same price),<sup>8</sup> and that the Preferred DPM Program is operating as a one-year pilot program.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,<sup>9</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>10</sup> 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.

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<sup>8</sup> See Phlx Rule 1014(g)(viii), Pacific Exchange Rule 6.82(d)(2), and American Stock Exchange Rule 935-ANTE(a)(4).

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

<sup>10</sup> 15 U.S.C. 78f(b)(5).

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

Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6) thereunder.<sup>12</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.

The CBOE has requested that the Commission waive the 30-day operative delay. The Commission believes it is consistent with the protection of investors and the public interest for the CBOE to implement the proposed rule change without delay. For this reason, the Commission designates the proposal to be effective and operative upon filing with the Commission.<sup>13</sup>

IV. Solicitation of Comments

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<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

<sup>13</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).



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-2005-45 on the subject line.

Paper comments:

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

All submissions should refer to File No. SR- CBOE-2005-45. 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing will also 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 No. SR- CBOE-2005-45 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>14</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).