

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52818; File No. SR-CBOE-2005-91)

November 22, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change and Amendment No. 1 Thereto Relating to its Marketing Fee Program

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 November 2, 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, II, and III below, which Items have been prepared by the Exchange. On November 17, 2005, the CBOE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The CBOE has designated this proposal as one changing a fee imposed by the CBOE under Section 19(b)(3)(A)(ii) of the Act<sup>4</sup> and Rule 19b-4(f)(2) thereunder,<sup>5</sup> which renders the proposal, as amended, effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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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> Partial Amendment No. 1 ("Amendment No. 1"): (1) amended the effective date of the proposal from November 1, 2005 to November 2, 2005; (2) amended the purpose section of the filing to clarify that the Preferred Market-Maker Program is a pilot program set to expire on June 2, 2006; (3) amended the rule text to specify that the marketing fee program will expire on June 2, 2006, the date the Preferred Market-Maker Program is set to expire; and (4) made a technical correction to a footnote.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>5</sup> 17 CFR 240.19b-4(f)(2).

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

The CBOE proposes to amend its Fees Schedule and its marketing fee program in a number of respects, including to permit a “Preferred Market-Maker” to direct the Exchange to disburse funds generated by the marketing fee where an order provider sends an order to the Exchange designating a Preferred Market-Maker. These changes to the marketing fee program would be effective November 2, 2005 and remain in effect until June 2, 2006, which is the date that CBOE’s pilot program establishing its Preferred Market-Maker program is scheduled to expire, unless extended through a rule filing submitted to and approved by the Commission .<sup>6</sup>

Below is the text of the proposed rule change, as amended. Proposed new language is underlined; proposed deletions are in [brackets].<sup>7</sup>

**CHICAGO BOARD OPTIONS EXCHANGE, INC.**

**FEES SCHEDULE**

**[October 25] November 2, 2005**

- 1. No Change.
- 2. **MARKETING FEE** (6)(16).....\$.22
- 3. – 4. No Change.

**FOOTNOTES:**

(1) – (5) No Change.

(6) The Marketing Fee will be assessed only on transactions of Market-Makers, RMMs, e-DPMs, DPMs, and LMMs at the rate of \$.22 per contract on all classes of equity options, options on HOLDRs, options on SPDRs, and options on DIA.

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<sup>6</sup> See Amendment No. 1, supra note 3.

<sup>7</sup> Id.

The fee will not apply to Market-Maker-to-Market-Maker transactions. This fee shall not apply to index options and options on ETFs (other than options on SPDRs and options on DIA). If less than 80% of the marketing fee funds are paid out by the DPM or LMM in a given month, then [Should any surplus of the marketing fees at the end of each month occur,] the Exchange would [then] refund such surplus at the end of the month[, if any,] on a pro rata basis based upon contributions made by the Market-Makers, RMMs, e-DPMs, DPMs and LMMs. However, if 80% or more of the accumulated funds in a given month are paid out by the DPM or LMM, there will not be a rebate for that month and the funds will carry over and will be included in the pool of funds to be used by the DPM or LMM the following month. At the end of each quarter, the Exchange would then refund any surplus, if any, on a pro rata basis based upon contributions made by the Market-Makers, RMMs, DPMs, e-DPMs and LMMs. CBOE's marketing fee program as described above will be in effect until June 2, 2006.

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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, as amended, and discussed any comments it received on the proposed rule change, as amended. 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 states that on October 29, 2004, it amended its marketing fee program.<sup>8</sup> The current marketing fee is assessed upon Designated Primary Market-Makers ("DPMs"), Electronic DPMs ("e-DPMs"), Remote Market-Makers ("RMMs"), Lead Market-Makers ("LMMs"), and Market-Makers at a rate of \$0.22 for every contract they enter into on the Exchange other than Market-Maker-to-Market-Maker transactions (which includes all transactions between any combination of DPMs, e-DPMs, RMMs, LMMs, and Market-Makers). The marketing fee is assessed in all equity option classes and options on HOLDRs<sup>®9</sup>, options on SPDRs<sup>®10</sup> and options on DIA.<sup>11</sup> The Exchange represents that the purpose of the marketing fee program is to provide the members of the Exchange with the ability to compete for the opportunity to trade with those orders that may otherwise be routed to other exchanges.

The Exchange states that under the current program, all funds generated by the marketing fee are collected by the Exchange and recorded according to the DPM or LMM, as applicable, station and class where the options subject to the fee are traded. The money collected is disbursed by the Exchange according to the instructions of the DPM or LMM. Those funds are made available to the

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<sup>8</sup> For a description of CBOE's marketing fee program, see Securities Exchange Act Release No. 50736 (November 24, 2004), 69 FR 69966 (December 1, 2004) (SR-CBOE-2004-68).

<sup>9</sup> HOLDRs are trust-issued receipts that represent an investor's beneficial ownership of a specified group of stocks. See Interpretation .07 to CBOE Rule 5.3.

<sup>10</sup> See, Securities Exchange Act Release No. 51052 (January 18, 2005), 70 FR 3757 (January 26, 2005) (SR-CBOE-2005-05).

<sup>11</sup> See, Securities Exchange Act Release No. 52474 (September 20, 2005), 70 FR 56520 (September 27, 2005) (SR-CBOE-2005-72).

DPM or LMM solely for those trading crowds where the fee was assessed and may only be used by that DPM or LMM to attract orders in the classes of options for which the fee was assessed.

CBOE recently obtained approval of a rule filing adopting a Preferred Market-Maker program.<sup>12</sup> Under that program, order providers can send an order to the Exchange designating any CBOE Market-Maker (including any DPM, e-DPM, LMM, RMM, and Market-Maker) as a Preferred Market-Maker. If the Preferred Market-Maker is quoting at the NBBO at the time the order is received on CBOE, the Preferred Market-Maker is entitled to a participation entitlement of 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 quoting at the best bid/offer on the Exchange.

CBOE proposes to amend its marketing fee program in a number of respects in light of the recent adoption of its Preferred Market-Maker program. These changes to the marketing fee program would be effective November 2, 2005 and expire on June 2, 2006, which is the date that CBOE's pilot program establishing its Preferred Market-Maker program is scheduled to expire, unless extended through a rule filing submitted to and approved by the Commission.<sup>13</sup> In particular, CBOE proposes to amend its marketing fee program to provide that a Market-Maker would have access to the marketing fee funds generated by orders sent to the Exchange designating that Market-Maker as a "Preferred Market-Maker."

The following is a description of the three-step process by which the entire pool of funds generated by the marketing fee would be apportioned between the DPM or LMM, and Preferred Market-Makers. First, consistent with the current program, each month all funds generated by the marketing fee would be collected by the Exchange and recorded according to the DPM or LMM, as

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<sup>12</sup> See Securities Exchange Act Release No. 52506 (September 23, 2005), 70 FR 57340 (September 30, 2005) (SR-CBOE-2005-58).

<sup>13</sup> See Amendment No. 1, supra note 3.

applicable, station and class where the option classes subject to the fee are traded. If a Market-Maker (including any DPM, e-DPM, LMM, and RMM) is designated as a Preferred Market-Maker on an order from a payment accepting firm ("PAF"), the Market-Maker would be given access to the marketing fee funds generated from that order, even if the Preferred Market-Maker did not participate in the execution of the order because the Market-Maker was not quoting at the NBBO at the time the order was received on CBOE.<sup>14</sup> The Exchange believes that it is appropriate to give Preferred Market-Makers access to all of the funds generated by the marketing fee for any order as to which they were designated the Preferred Market-Maker because the Preferred Market-Maker negotiated with a PAF to send their order flow to CBOE and to designate a particular Market-Maker as the Preferred Market-Maker. Second, the DPM or LMM, as applicable, would be given access to the marketing fee funds generated from all other orders from PAFs in its appointed classes in a particular trading station. Third, the marketing fee funds generated by orders from non-PAFs, if any, would be apportioned monthly among the DPM or LMM, and Preferred Market-Makers on a on a pro-rata basis, based on the percentage of contracts traded by each DPM or LMM and Preferred Market-Maker against orders from PAFs during the month in the option classes located at a particular trading station.

The following is an example of how funds generated from CBOE's marketing fee program would be allocated to Preferred Market-Makers, DPMs, and LMMs pursuant to the preceding three steps. As noted above, each month all funds generated by the marketing fee are collected by the Exchange and recorded according to the DPM or LMM, as applicable, station and class where the option classes subject to the fee are traded. Thus, assuming 45,455 contracts traded in a particular

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<sup>14</sup> For example, assume a Market-Maker is designated as a Preferred Market-Maker on an order for 50 contracts which is executed on CBOE. Under this first step, the Preferred Market-Maker would be given access to a total of \$11 (50 contracts x \$.22), whether or not the Preferred Market-Maker traded with the order or not.

month at Station 1 on the trading floor, \$10,000 (45,455 contracts X \$.22) would be generated as a result of the marketing fee to be used to attract order flow to CBOE.

Pursuant to Step 1, assuming the DPM and two other Market-Makers were designated as Preferred Market-Makers for orders executed in option classes at Station 1, they would be allocated the following funds:

	Contracts	Funds Allocated
DPM	5,000	\$1,100 (\$ .22 * 5,000)
Preferred Market-Maker #1	2,500	\$550 (\$ .22 * 2,500)
Preferred Market-Maker #2	3,500	\$770 (\$ .22 * 3,500)
Total	11,000	\$2,420 (\$ .22 * 11,000)

Pursuant to Step 2, the Exchange would determine the amount funds generated from orders from PAFs that were executed in option classes at Station 1, and these funds would be allocated to the DPM to attract order flow to CBOE. Assuming orders from PAFs representing 10,000 contracts were executed with Market-Makers (including the DPM or LMM, e-DPM(s), and RMM(s)), at Station 1, \$2,200 (10,000\*\$.22) in funds would be generated and allocated to the DPM.

As a result of Steps 1 and 2 above, the original pool of funds generated by the marketing fee at Station (\$10,000), would have been depleted in Step 1 by \$2,420, and in Step 2 by \$2,200.

Assuming remaining number of contracts executed at Station 1, i.e., 24,455 contracts<sup>15</sup>, were from orders from non-PAFs, a total of \$5,380 (24,455\*\$.22) would be the remaining balance of funds.

Pursuant to Step 3, these funds would be apportioned monthly among the DPM (or LMM) and Preferred Market-Makers on a on a pro-rata basis, based on the percentage of contracts traded by each DPM (or LMM) and Preferred Market-Maker against orders from PAFs. Assuming the DPM and the two Preferred Market-Makers executed the following percentage of contracts from orders from PAFs at Station 1, they would be allocated the following funds:

	% of PAF Contracts	Funds Allocated
DPM	65%	\$3,497 (65% * \$5,380)
Preferred Market-Maker #1	15%	\$807 (15% * \$5,380)
Preferred Market-Maker #2	20%	\$1,076 (20% * \$5,380)

The funds generated by the marketing fee would continue to be collected by the Exchange and recorded according to the applicable trading station and class where the options subject to the fee are traded. The money collected would be disbursed by the Exchange according to the instructions of the DPM, LMM or the Preferred Market-Maker. These funds shall only be used to attract order flow to CBOE from PAF, and the funds made available to the DPM or LMM may only be used to attract orders in the option classes located at the trading station where the fee was assessed. Thus, a member organization appointed as the DPM at a particular trading station on the trading floor cannot use the

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<sup>15</sup> 45,455 less 11,000 contracts (see Step 1) and 10,000 contracts (see Step 2).

funds from that trading station to attract order flow to another trading station on the trading floor where that member serves as the DPM.

Additionally, the Exchange does not intend to continue to require that the funds collected from e-DPMs and RMMs can only be used to attract order flow for the classes in which the e-DPM or RMM is appointed. The Exchange does not believe such a restriction is necessary or reasonable in light of manner in which firms negotiate with PAFs to direct their order flow to the Exchange. Specifically, the Exchange notes that many DPMs or LMMs negotiate with PAFs to route their order flow to the Exchange for all of the classes located at a particular trading station, and not necessarily on a class-by-class basis. Additionally, any use of the marketing fees by the DPM outside of an RMM's or an e-DPM's appointment may still benefit the RMM or e-DPM because e-DPMs and RMMs are permitted under Exchange rules to enter orders in option classes traded on the Exchange that are not included within their appointment. Therefore, the Exchange believes that there is an equitable allocation of use of the fees by the DPM because the order flow from a PAF can be accessed by an RMM or eDPM, outside their appointments, through "M" orders.

In the event a Preferred Market-Maker does not disburse all of the funds generated by the marketing fee in a given month, than the funds the Preferred Market-Maker does not disburse would be made available to the DPM or LMM, as applicable, for the following month to attract orders in the classes of options where the DPM or LMM is appointed.

Finally, the Exchange proposes to amend the program with respect to the manner in which surplus funds are refunded to Market-Makers, RMMs, DPMs, e-DPMs, and LMMs. Currently, the Exchange refunds any surplus at the end of the month on a pro rata basis based upon contributions made by the Market-Makers, RMMs, DPMs, e-DPMs, and LMMs. Going forward, if 80% or more of the accumulated funds in a given month are paid out by the DPM or LMM, there would not be a

rebate for that month and the funds would carry over and would be included in the pool of funds to be used by the DPM or LMM in the following month. If less than 80% of the funds is paid out, Market-Maker rebates would continue to be made on a monthly basis. At the end of each quarter, the Exchange would then refund any surplus, if any, on a pro rata basis based upon contributions made by the Market-Makers, RMMs, DPMs, e-DPMs, and LMMs.

In the foregoing example, the DPM and Preferred Market-Maker #1 and Preferred Market-Maker #1 were allocated the following amounts:

	Total Allocated
DPM	\$6,797 (\$1,100 + \$2,200 + \$3,497)
Preferred Market-Maker #1	\$1,357 (\$550 + \$807)
Preferred Market-Maker #2	\$1,846 (\$770 + \$1076)

If the DPM only paid out a total of \$6,150 of the \$6,797 allocated to it in a given month (or 90% of its funds), then \$647 would carry over for the DPM to use to attract order in the following month. If Preferred Market-Maker #1 paid out a total of \$1,200 of the \$1,357 allocated to it in a given month, then \$157 would be made available to the DPM (or LMM) for the following month to attract orders in the classes of options where the DPM (or LMM) is appointed. If Preferred Market-Maker #2 paid out a total of \$1,846 allocated to it in a given month, then none of Preferred Market-Maker #2's funds would carry over to the DPM (or LMM) for the following month.

As in the current marketing fee program, the Exchange would not be involved in the determination of the terms governing the orders that qualify for payment with any PAF or the amount of any such payment. The Exchange would provide administrative support for the program in such matters as maintaining the funds, keeping track of the number of qualified orders each firm directs to the Exchange, and making the necessary debits and credits to the accounts of the traders and the PAFs to reflect the payments that are made. Exchange Market-Makers, RMMs, DPMs, e-DPMs, and LMMs would have no way of identifying prior to execution whether a particular order is from a PAF or a non-PAF.

## 2. Statutory Basis

The Exchange believes that its proposal, as amended, is consistent with Section 6(b) of the Act<sup>16</sup> in general, and furthers the objectives of Section 6(b)(4) of the Act<sup>17</sup> in particular, in that it is an equitable allocation of reasonable dues, fees, and other charges among CBOE members and other persons using its facilities.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change, as amended, will impose any inappropriate 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 either solicited or received.

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<sup>16</sup> 15 U.S.C. 78f(b).

<sup>17</sup> 15 U.S.C. 78f(b)(4).

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change, as amended, has been designated as a fee change pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>18</sup> and Rule 19b-4(f)(2)<sup>19</sup> thereunder, because it establishes or changes a due, fee, or other charge imposed by the Exchange. Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of such proposed rule change, as amended, 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.<sup>20</sup>

### 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-2005-91 on the subject line.

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<sup>18</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>19</sup> 17 CFR 240.19b-4(f)(2).

<sup>20</sup> The effective date of the original proposed rule change is November 2, 2005, the effective date of Amendment No. 1 is November 17, 2005. For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposal, the Commission considers the period to commence on November 17, 2005, the date on which the Exchange submitted Amendment No. 1.

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-2005-91. 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, as amended, 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-2005-91 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>21</sup>

Jonathan G. Katz  
Secretary

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<sup>21</sup> 17 CFR 200.30-3(a)(12).