

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50115; File No. SR-OC-2004-01)

July 29, 2004

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the OneChicago, LLC Relating to its Market Maker Registration Policy and Procedures

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 July 23, 2004, OneChicago, LLC (“OneChicago” 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 OneChicago. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons, and to grant accelerated approval of the proposed rule change.

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

OneChicago proposes to adopt new Market Maker Registration Policy and Procedures. The text of the proposed rule change appears below. New language is in italics.

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OneChicago

Market Maker Registration Policy and Procedures

OneChicago Market Maker Program

Pursuant to OneChicago Rule 514, the Exchange has adopted a market maker program under which clearing members or exchange members (collectively, “members”) may be

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

designated as market makers in respect of one or more OneChicago contracts (“Contracts”) to provide liquidity and orderliness in the market for such Contracts. To be designated as a OneChicago market maker, a member must complete and file with the Exchange a OneChicago Market Maker Registration Form (attached below). By signing the registration form the member will confirm that it meets and will continue to meet the qualifications to act as market maker in accordance with OneChicago Rules. The member will be required to identify all OneChicago Contracts for which it seeks to be designated as a market maker and elect which of the three alternative sets of market maker obligations specified in OneChicago Rule 515(n) it intends to undertake.

Market Maker Exclusion from OneChicago Customer Margin Requirements

To qualify for the market maker exclusion for purposes of OneChicago’s customer margin rules, a person must:

- (1) be a OneChicago member that is registered with OneChicago as a dealer in security futures as defined in Section 3(a)(5) of the Securities Exchange Act of 1934 (“Exchange Act”);
- (2) be registered as a floor trader or a floor broker under Section 4f(a)(1) of the Commodity Exchange Act (“CEA”) or as a dealer with the Securities and Exchange Commission (“SEC”) under Section 15(b) of the Exchange Act;
- (3) maintain records sufficient to prove compliance with the requirements of OneChicago Rule 515(n) and the Commodity Futures Trading Commission (“CFTC”) Rule 41.42(c)(2)(v) and SEC Rule 400(c)(2)(v) under the Exchange Act as applicable, including without limitation trading account statements and other financial records sufficient to detail activity; and

(4) hold itself out as being willing to buy and sell security futures for its own account on a regular or continuous basis.

In addition, the market maker exclusion provides that any market maker that fails to comply with the rules of OneChicago or the margin rules adopted by the SEC and the CFTC shall be subject to disciplinary action in accordance with Chapter 7 of OneChicago's Rules, and that appropriate sanctions in the case of any such failure shall include, without limitation, a revocation of such market maker's registration as a dealer in security futures.

Market Maker Categories

OneChicago Rule 515(n) specifies three alternative ways for a member to satisfy the requirement that a market maker hold itself out as being willing to buy and sell security futures for its own account on a regular or continuous basis. Each member seeking market maker designation must register for one of the following three market maker categories and will undertake to perform all of the obligations set forth in the elected category:

Category 1. The market maker will provide continuous two-sided quotations throughout the trading day for all delivery months of Contracts representing a meaningful proportion of the total trading volume on the Exchange,* subject to relaxation during unusual market conditions as determined by OneChicago (such as a fast market in either a Contract or a security underlying such Contract) at which times such market maker must use its best efforts to quote continuously and competitively; and when providing quotations, quotes for a minimum of one Contract with a maximum bid/ask

* A "meaningful proportion of the total trading volume on the Exchange" shall mean a minimum of 20 per cent of such trading volume.

spread of no more than the greater of \$0.20 or 150 per cent of the bid/ask spread in the primary market for the security underlying each Contract; or

Category 2. The market maker will respond to at least 75 per cent of the requests for quotations for all delivery months of Contracts representing a meaningful proportion of the total trading volume on the Exchange, subject to relaxation during unusual market conditions as determined by the Exchange (such as fast market in either a Contract or a security underlying such Contract) at which times such market maker must use its best efforts to quote competitively; and when responding to requests for quotation, quotes within five seconds for a minimum of one Contract with a maximum bid/ask spread of no more than the greater of \$0.20 or 150 per cent of the bid/ask spread in the primary market for the security underlying each Contract; or

Category 3. The market maker will be (i) assigned to a group of Contracts that is either unlimited in nature (“Unlimited Assignment”) or is assigned to no more than 20 per cent of the Contracts listed on OneChicago (“Limited Assignment”); (ii) at least 75 per cent of such market maker’s total trading activity in Exchange products is in its assigned Contracts, measured on a quarterly basis; (iii) during at least 50 per cent of the trading day such market maker has bids or offers in the market that are at or near the best market, except in unusual market conditions as determined by OneChicago (such as fast market in either a Contract or a security underlying such Contract), with respect to at least 25 per cent (in the case of an Unlimited Assignment) or at least one (in the case of a Limited Assignment) of its assigned Contracts;

and (iv) the requirements set forth in (ii) and (iii) are satisfied on at least 90 per cent (in the case of an Unlimited Assignment) or 80 per cent (in the case of a Limited Assignment) of the trading days in each calendar quarter.

Qualification for “60/40” Tax Treatment

To qualify as a “dealer” in security futures contracts within the meaning of Section 1256(g)(9) of the Internal Revenue Code of 1986, as amended, (the “Code”) a member is required (i) to register as a market maker for purposes of OneChicago’s margin rules under Category 1 or Category 2 above; (ii) to undertake in its registration form to provide quotations for all products specified for the market maker exclusion from the OneChicago margin rules; and (iii) to quote a minimum size of

(A) ten (10) contracts for each product not covered by (B) or (C) below;

(B) five (5) contracts for each product specified by the member to the extent such quotations are provided for delivery months other than the next two delivery months then trading; and

(C) one (1) contract for any single stock futures Contract where the average market price for the underlying stock was \$100 or higher for the preceding calendar month or for any futures contract on a narrow-based security index, as defined by Section 1a(25) of the CEA.

Products

As noted above in completing the OneChicago Market Maker Registration Form, a member must specify all OneChicago Contracts for which it intends to act as a market maker. The Exchange will assign to the member all of the Contracts listed on its registration form, unless the Exchange provides written notice to the member identifying any Contracts for

which such assignment is withheld. A member may change the list of Contracts for which he undertakes to act as market maker for any calendar quarter by filing a revised Market Maker Registration Form with the Exchange on any business day prior to the last trading day of such quarter, and such change shall be effective retroactive to the first trading day of such quarter. Each market maker shall be responsible for maintaining books and records that confirm that it has fulfilled its quarterly obligations under the market maker category elected on its Market Maker Registration Form in respect of all Contracts designated for that calendar quarter.

* * * * *

514. Market Maker Programs

The Exchange may from time to time adopt one or more programs under which one or more Clearing Members or Exchange Members may be designated as market makers with respect to one or more Contracts in order to provide liquidity and orderliness in the market or markets for such Contract or Contracts. Any such program may provide for any or all of the following:

- (a) qualifications, including any minimum net capital requirements, that any such market maker must satisfy;
- (b) the procedure by which Clearing Members or Exchange Members may seek and receive designation as market makers;
- (c) the obligations of such market makers, including any applicable minimum bid and offer commitments; and
- (d) the benefits accruing to such market makers, including priority in the

execution of transactions effected by Clearing Members or Exchange Members in their capacity as market makers, reduced transaction fees or the receipt of compensatory payments from the Exchange.

Without limiting the generality of the foregoing, the Exchange may adopt a program under which one or more Clearing Members or Exchange Members may be designated as lead market makers, and as such, allocated certain numbers and types of Contracts with respect to which they are required to make two-sided markets. For further details see “Market Maker Registration Policy and Procedures” at www.onechicago.com/020000_about/oc_020400.html.

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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, OneChicago 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. OneChicago 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

Pursuant to OneChicago Rule 514, the Exchange has adopted a market maker program in which clearing members or exchange members (collectively, “members”) may be designated as market makers in respect to one or more OneChicago contracts (“Contracts”) to provide liquidity and orderliness in the market for such Contracts. The

proposed rule change sets forth the procedures necessary for members to be designated as market makers and the policies in relation to such designation. In addition, the Exchange is making a corresponding amendment to OneChicago Rule 514.

The proposed rule change reiterates the qualifications that members must meet pursuant to OneChicago Rule 515(n) to qualify for the market maker exclusion from customer margin.³ In addition, the proposed rule change reminds members that under Chapter 7 of the OneChicago rules, failure to comply with OneChicago's rules or the margin rules adopted by the Commission and the Commodity Futures Trading Commission ("CFTC") are subject to disciplinary action. The appropriate sanctions for any such failure shall include, without limitation, a revocation of such market maker's registration as a dealer in security futures.

Under the proposed rule change, a member seeking a market maker designation must submit a Market Maker Registration Form to the Exchange. By signing the registration form, the member confirms that it meets and will continue to meet the qualifications to act as a market maker in accordance with the Exchange's rules. The

³ To qualify for the market maker exclusion for purposes of OneChicago's customer margin rules a person must:

1. be a OneChicago member that is registered with OneChicago as a dealer in security futures;
2. be registered as a floor trader or a floor broker under Section 4f(a)(1) of the Commodity Exchange Act ("CEA") or as a dealer with the Commission under Section 15(b) of the Act;
3. maintain records sufficient to prove compliance with the requirements of OneChicago Rule 515(n) and the CFTC Rule 41.42(c)(2)(v) or Rule 400(c)(2)(v) under the Act as applicable, including without limitation trading account statements and other financial records sufficient to detail activity; and
4. hold itself out as being willing to buy and sell security futures for its own account on a regular or continuous basis.

registration form requires members to list all the Contracts in which they will act as market makers. The registration form also requires a member to identify the qualifying market maker category under OneChicago Rule 515(n)(ii)(C).⁴

The proposed rule change establishes that the Exchange will assign to the member all Contracts listed by the member on its registration form, unless the Exchange provides written notice to the member identifying any Contracts for which such assignment is withheld. Under the proposed rule change, for any calendar quarter, a market maker may change the list of Contracts for which it is designated by filing a revised registration form prior to the last trading day in such calendar quarter. Such change in Contract designation will be effective retroactive to the first trading day of such quarter. The proposed rule change also makes clear that each market maker is responsible for maintaining books and records that confirm that it has fulfilled its quarterly obligations under the market maker category as elected on its registration form for all designated Contracts for that quarter. Under the proposal, each market maker would also be required to maintain such books and records for every Contract and for each calendar quarter in which its designation as market maker is maintained.

In addition, the proposed rule change sets forth the requirements that must be met to qualify as a “dealer” in security futures contracts within the meaning of Section 1256(g)(9) of the Internal Revenue Code of 1986⁵, as amended (the “Code”). Under the proposed rule change, to qualify as a dealer within the meaning of the Code a member is required (i) to

⁴ Under OneChicago Rule 515(n)(ii)(C), there are three alternative ways for a member to satisfy the requirement that security futures dealer hold itself out as being willing to buy and sell security futures for its own account on a regular or continuous basis.

⁵ 26 U.S.C. 1256(g)(9).

register as a market maker for purposes of OneChicago's margin rules under Category 1 or 2 (OneChicago Rule 515(n)(iii)(1) or (2)); (ii) to undertake in its registration form to provide quotations for all products specified for the market maker exclusion from the OneChicago margin rules; and (iii) for each delivery month to quote a minimum size of

(A) ten contracts of a product not covered by (B) or (C) below;

(B) five contracts of a product specified by the market maker for delivery months other than the next two delivery months trading at the time the quotations are made;⁶

(C) one contract of any single stock futures product where the average market price for the underlying stock was \$100 or higher for the preceding calendar month or for each delivery month of any futures contract on a narrow-based security index, as defined by Section 1a(25) of the CEA.

2. Statutory Basis

OneChicago believes that the proposal is consistent with Section 6(b) of the Act,⁷ in general, and Section 6(b)(5) of the Act,⁸ in particular, which requires, among other things, that exchange rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and in general to protect investors and the public interest. The Exchange believes that the proposed rule change establishes procedures and policies for its market maker program, which, according to OneChicago, is

⁶ Under this requirement a market maker must quote for at least five contracts when it is quoting in the back delivery months. For example, a market maker designated to trade Contracts on XYZ, Corp, which is trading two quarterly and two serial months (the March Contract, the April Contract, the May Contract and the June Contract), would be required to have a size of at least five Contracts for its quotes in the May and June Contracts in order for the market maker to qualify as a "dealer" for purposes of Section 1256(g)(9) of the Code. 26 U.S.C. 1256(g)(9).

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(4).

designed to provide liquidity and orderliness in the market for OneChicago Contracts. Thus, OneChicago believes that the proposed rule change promotes just and equitable principles of trade and protects investors and the public interest.

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

OneChicago 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

Written comments were neither solicited nor received with respect to the proposed rule change.

III. Solicitation of Comments

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>);
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OC-2004-01 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and OneChicago Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-OC-2004-01. 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 20549-0609. Copies of such filing also will be available for inspection and copying at the principal office of OneChicago. 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-OC-2004-01 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission Findings and Order Granting Accelerated Approval of a Proposed Rule Change

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁹ In particular, the Commission believes that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,¹⁰ which requires, among other things, that the rules of the Exchange be designed to promote just and equitable

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ 15 U.S.C. 78f(b)(5).

principles of trade and, in general, to protect investors and the public interest.¹¹ In addition, the Commission believes that the proposed rule change is consistent with Section 7(c)(2)(B) of the Act,¹² which provides, among other things, that the margin requirements for security futures must preserve the financial integrity of markets trading security futures and prevent systemic risk. The Commission also believes that the proposed rule change is consistent with Rule 400(c)(2)(v) under the Act,¹³ which permits a national securities exchange to adopt rules containing specified requirements for security futures dealers to qualify for an exclusion from the margin requirements for securities futures under Section 7(c)(2)(B) of the Act.¹⁴ The Commission believes that the proposed obligations for market makers satisfy this requirement. Specifically, the Commission believes that the Exchange's market maker registration policy and procedures, and the qualification requirements for "60/40" tax treatment should help ensure that market makers provide liquidity and orderliness in the market for OneChicago Contracts.

OneChicago has requested that the Commission approve the proposed rule change prior to the thirtieth day after publication of notice of the filing in the Federal Register. The Commission believes that the market maker registration policy and procedures, and the qualification requirements for "60/40" tax treatment, are an extension of the obligations previously adopted in connection with OneChicago's Margin Rule,¹⁵ which sets forth the

¹¹ In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78g(c)(2)(B).

¹³ 17 CFR 242.400(c)(2)(v).

¹⁴ 15 U.S.C. 78g(c)(2)(B).

¹⁵ See Securities Exchange Act Release No. 47810 (May 7, 2003), 68 FR 26369 (May 15, 2003).

standards under which a OneChicago member may be excluded from the Exchange's margin requirements as a "market maker," and therefore should raise no novel regulatory issues related to margin requirements. Accordingly, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,¹⁶ to approve the proposed rule change prior to the thirtieth day after publication of the notice of filing thereof in the Federal Register.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act¹⁷, that the proposed rule change (File No. SR-OC-2004-01) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁸

Margaret H. McFarland
Deputy Secretary

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 15 U.S.C. 78s(b)(2).

¹⁸ 17 CFR 200.30-3(a)(12).