

number of issues traded on the Options Floor.]

[(4)] (3) *Evaluation of LMMs.* The Options Allocation Committee shall monitor and evaluate the performance of LMMs with regard to quality of markets and shall do so at least semiannually. In reviewing and evaluating an LMM's performance, the Committee will consider, among other things, the LMM's evaluation conducted pursuant to [Options Floor Procedure Advice B-13] *Rule 6.100*, the LMM's compliance with Exchange Rules, including, but not limited to, Rule 6.32 through 6.40 and Article XI, Section 2 of the Exchange Constitution.

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Guidelines of the Options Allocation Committee

The Options Allocation Committee has developed a guideline to assist the Committee in its review of matters that affect the level of LMM concentration on the Exchange. The Committee intends to evaluate matters related to the LMM concentration by considering a number of factors, including the number of issues allocated to an LMM and the contract volume in the products allocated to a LMM.

Under the Committee's guidelines, the Committee intends to take into consideration an LMM's level of concentration if there is an event or proposal that would cause an LMM to meet either of the following criteria:

1. The number of issues allocated to an LMM (and any affiliated LMM) is 25% or more of the total number of issues traded on the PCX;

2. The volume in the issues allocated to an LMM (and any affiliated LMM) is 50% or more of the total volume of the PCX or 25% or more of the total volume in equity option issues of the PCX.

If there is an event or proposal that would cause an LMM to reach either of the two above criteria (such as, for example, the allocation to an LMM of additional issues or a proposal involving a transfer of interest in an LMM organization), the Committee will carefully evaluate the level of concentration that would result. If the Committee determines that the event or proposal would result in an unacceptable level of concentration, the Committee could exercise its discretion and take action to lower the resulting level of concentration or to deny the applicable proposal. The Committee retains the discretion to review an LMM's level of concentration at any time regardless of whether the above criteria are satisfied.

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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 PCX 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 PCX 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

Current PCX Rule 6.82(e) provides that the allocation of option issues to an LMM is effected by the Options Allocations Committee ("OAC"). Under this rule, the OAC selects the candidate who appears best able to perform the function of an LMM in a particular designated option issue. Factors to be considered for selection include, but are not limited to: experience with trading the option issue; adequacy of capital; willingness to promote the Exchange as a marketplace; operational capacity; support personnel; history of adherence to Exchange rules and securities laws; trading crowd evaluations made pursuant to Options Floor Procedure Advice ("OFPA") B-13 (renumbered Rule 6.100)⁴, and any other criteria specified in Rule 6.82. In addition to the above, the rule provides that in the absence of extraordinary circumstances, as determined by the OAC, the OAC may not allocate more than 15% of the number of issues traded on the Options Floor to any LMM.⁵

The options industry continues to experience a consolidation and withdrawal of liquidity providers and therefore, the Exchange is proposing a rule change that would eliminate the 15% LMM concentration limit and replace it with a provision that would require the OAC to consider the number and quality of issues that it has allocated, reallocated or transferred to an LMM. Consistently, the Exchange seeks to apply a guideline developed by the OAC in order to assist it in its review of matters that affect the level of

LMM concentration on the Exchange. The guideline requires the OAC to take into consideration the concentration of an LMM's issues if there is an event or proposal that would cause an LMM to meet either of the following criteria: (i) the number of issues allocated to an LMM (and any affiliated LMM) is 25% or more of the total number of issues traded on the PCX; or (ii) the volume in the issues allocated to an LMM (and any affiliated LMM) is 50% or more of the total volume of the PCX or 25% or more of the total volume in equity option issues of the PCX. If an LMM meets either of the two above criteria, the guideline requires the OAC to evaluate the level of concentration and determine whether the event or proposal would result in an unacceptable level of concentration. If so, the OAC could exercise its discretion and take action to lower the resulting level of concentration or to deny the applicable proposal. Pursuant to the guideline, the OAC will retain the discretion to review an LMM's level of concentration at any time regardless of whether the above criteria are satisfied.

The Exchange believes that the rule change and accompanying guideline are necessary to assure not only that the OAC has the discretion to allocate an issue to the most qualified LMM, but also to maintain a competitive advantage relative to other options exchanges with respect to the number of issues that an LMM may be allocated.⁶

2. Statutory Basis

The Exchange believes that the proposed rule changes are consistent with section 6(b)⁷ of the Act, in general, and further the objectives of section 6(b)(5),⁸ in particular, in that they are designed to facilitate transactions in securities, to promote just and equitable principles of trade, to enhance competition, to perfect the mechanism of a free and open market and to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not

⁴ See Securities and Exchange Act Release No. 44345 (May 23, 2001), 66 FR 30037 (June 4, 2001).

⁵ In 2000, the Commission approved a PCX proposal to increase the cap on the percentage of issues per LMM from 10% to 15%. See Securities and Exchange Act Release No. 42583 (March 28, 2000), 65 FR 17689 (April 4, 2000).

⁶ The Exchange notes that the Chicago Board Options Exchange ("CBOE") has a guideline, which dates back to 1999, that has no mandatory cap on the number of issues that may be allocated to a Designated Primary Market-Maker ("DPM"). The CBOE guideline may trigger a review with the relevant committee when, *inter alia*, the number of classes allocated to a DPM is 25% or more of the total number of classes traded on CBOE. See CBOE Regulatory Guideline 99-135.

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).