

fee program.<sup>3</sup> The text of the proposed rule change is available at the CBOE and at the Commission.

## 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 III 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

Effective August 1, 2001, the CBOE suspended its \$.40 per contract marketing fee.<sup>4</sup> As described in SR-CBOE-2003-19,<sup>5</sup> the CBOE has determined to reinstate its marketing fee program, and proposes to adopt the procedures set forth in proposed new Interpretation and Policy .12 to CBOE Rule 8.7 to specify how a trading crowd determines whether or not to participate in the marketing fee program. The CBOE proposes to institute these procedures on a pilot basis to expire one year after Commission approval. The Exchange has requested that the Commission approve the pilot program on an accelerated basis so that it can compete effectively with other exchanges that have marketing fee programs.

As described in SR-CBOE-2003-19, the marketing fee will be assessed only on those market-maker transactions (including DPMs) resulting from orders from customers of payment-accepting firms with which the DPM has agreed to pay for that firm's order flow. In the instant filing, the CBOE proposes that after the marketing fee initially has been in effect for three consecutive calendar months with respect to the option classes located at a particular trading station, the members of a trading crowd may determine not to continue participating in this marketing fee program pursuant to the procedures proposed to be set forth in Interpretation

.12 to CBOE Rule 8.7, as described below. The CBOE asserts that these procedures are substantially the same as the procedures contained in Interpretation and Policy .03 to CBOE Rule 8.95. These procedures were utilized by trading crowds in 1999 to indicate that they no longer wish to trade an option class opened for trading prior to May 1, 1987.<sup>6</sup>

The Exchange states that two procedural aspects of the administration of the trading crowd vote are embodied in proposed Interpretation and Policy .12 to CBOE Rule 8.7: (i) To define which trading crowd<sup>7</sup> members are entitled to participate in the vote; and (ii) to adopt voting procedures to be used for purposes of determinations made under the rule. The CBOE states that proposed Interpretation and Policy .12 provides that eligible trading crowd members are those market-makers in the subject trading crowd who have transacted at least 80% of their market-maker contracts and transactions in each of the three immediately preceding calendar months in option classes traded at that trading crowd's station, and who continue to be present in the trading crowd in the capacity of a market maker at the time of the vote.<sup>8</sup> According to the CBOE, this assures that only those members who are currently engaged as market makers in that trading crowd, and who have concentrated their activity in that trading crowd over the last three months, participate in the vote.

#### Process To Request a Vote

The CBOE asserts that the DPM or any eligible trading crowd member may request that a vote be held by submitting a written request to that effect to the Secretary of the Exchange. The Exchange will provide at least ten

calendar days' posted notice to the trading crowd of the time and date of the vote. The Secretary of the Exchange will verify that the member requesting a vote is an eligible trading crowd member and will keep the identity of such individual confidential.

#### Trading Crowd Participating in Marketing Fee Program

The CBOE states that after a trading crowd has participated in the marketing fee program for the initial three consecutive calendar month period, the trading crowd may determine to opt-out of the program. Proposed Interpretation and Policy .12 to CBOE Rule 8.7 provides that a trading crowd will be deemed to have indicated that it does not wish to continue participating in the marketing fee program only if: (i) The question is put to a vote of the eligible trading crowd members;<sup>9</sup> (ii) a majority of the eligible trading crowd members participate in the vote; and (iii) a majority of the votes cast are in favor of not participating in the marketing fee program. In the event the vote of the members of the trading crowd is tied, the marketing fee program will remain in effect in that trading crowd for the next three consecutive months.

#### Trading Crowd Not Participating in Marketing Fee Program

According to the Exchange, twenty days after a trading crowd votes not to participate in the marketing fee program, any eligible trading crowd member may then request that another vote be held to determine whether the trading crowd should participate in the marketing fee program.<sup>10</sup> In this case, if a majority of the votes cast are in favor of participating in the marketing fee program, the trading crowd will be deemed to have indicated that it wishes to participate in the marketing fee program and the marketing fee program will be in effect in that trading crowd for the next three consecutive months. In the event that the vote of the members of the trading crowd is tied, the trading crowd will be deemed to have indicated that it does not wish to participate in the marketing fee program.

The CBOE asserts that these voting procedures are substantially similar to

<sup>6</sup> See Exchange Act Release No. 41641 (July 22, 1999), 64 FR 41477 (July 30, 1999), granting immediate effectiveness to SR-CBOE-99-31.

<sup>7</sup> CBOE Rule 8.8.01 provides that the term "trading crowd" is synonymous with the term trading "station." That rule defines "station" as "a location on the trading floor, at which classes of option contracts are traded, which classes of options compose all or part of a market maker appointment. An appointment must at least include all of the classes of options traded at one station." The same definition of "trading crowd" applies to proposed Interpretation and Policy .12 to CBOE Rule 8.7.

<sup>8</sup> The CBOE represents that it routinely monitors market maker trading activity for purposes of determining compliance with CBOE Rule 8.7.03 appointment and in-person trading requirements. Additionally, the CBOE represents that it has committed to monitor market maker trading activity for purposes of determining compliance with the electronic quoting requirements proposed in CBOE-2002-05 (the Hybrid Trading System). As such, the CBOE believes that it has the capability to determine who constitutes an eligible trading crowd member for purposes of this rule filing.

<sup>9</sup> The DPM is considered an eligible trading crowd member and, as such, may (but is not required to) participate in the vote. The DPM entity is entitled to only one vote regardless of the number of nominees or representatives it employs in the trading crowd.

<sup>10</sup> The CBOE notes that actual votes may only be held once every thirty days. Because there is a ten calendar day notice period prior to a vote, however, an eligible trading crowd member may request a vote twenty days after the preceding vote.

<sup>3</sup> The CBOE recently reinstated its payment for order flow program. See Exchange Act Release No. 47948 (May 30, 2003) (SR-CBOE-2003-19).

<sup>4</sup> See Exchange Act Release No. 44717 (August 16, 2001), 66 FR 44655 (August 24, 2001), (SR-CBOE-2001-43).

<sup>5</sup> See Exchange Act Release No. 47948 (May 30, 2003), (SR-CBOE-2003-19).