

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-53629; File No. SR-CBOT-2006-02]

### Self-Regulatory Organizations; Board of Trade of the City of Chicago, Inc.; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change Relating to Security Futures Market Maker Registration Policy and Procedures

April 10, 2006.

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 March 16, 2006, the Board of Trade of the City of Chicago, Inc. (“CBOT” 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 CBOT. The Commission is publishing this notice and order to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposed rule change.

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

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

\* \* \* \* \*

#### Chicago Board of Trade Security Futures Market Maker

##### Registration Policy and Procedures

##### Security Futures Market Maker Program

Pursuant to CBOT® Rule 225.00, the Exchange has adopted a security futures market maker program under which an individual member or member firm (each referred to as a “member” herein) may be registered with the CBOT as a “Security Futures Dealer” with respect to one or more security futures contracts traded on the Exchange, to provide liquidity and orderliness in the market for such contracts. In order to be registered as a Security Futures Dealer, the member must complete and file with the Exchange, a CBOT Security Futures Dealer Registration Form (attached below). The member will be required to identify all CBOT security futures contracts for which it seeks to be registered as a Security Futures Dealer and to elect one of the categories of

market maker obligations set forth in CBOT Regulation 431.07(c), which are described below. By signing the Registration Form, the member will confirm that it meets and will continue to meet the requirements to act as a security futures market maker under CBOT Rules and Regulations.

##### Market Maker Exclusion From Security Futures Customer Margin Requirements

A member that is a security futures market maker will be excluded from the security futures customer margin requirements set forth in CBOT Regulation 431.07, if the member meets all of the following qualifications:

(i) The member must be registered with the Exchange as a dealer in security futures as defined in Section 3(a)(5) of the Securities Exchange Act of 1934 (“Exchange Act”); and

(ii) The member must be registered as a floor broker or a floor trader under section 4f(a)(1) of the Commodity Exchange Act (“CEA”), or be registered as a dealer with the Securities and Exchange Commission (“SEC”) under Section 15(b) of the Exchange Act; and

(iii) The member must maintain records sufficient to prove compliance with the requirements set forth in CBOT Regulation 431.07 and Commodity Futures Trading Commission (“CFTC”) Regulation 41.42(c)(2)(v) or SEC Regulation 242.400(c)(2)(v), as applicable, including without limitation, trading account statements and other financial records sufficient to detail activity; and

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

CBOT Regulation 431.07 also provides that any market maker that fails to comply with applicable CBOT, CFTC, or SEC Rules or Regulations, shall be subject to disciplinary action in accordance with Chapter 5 of the CBOT Rulebook. Appropriate sanctions in the case of any such failure shall include, without limitation, a revocation of the market maker’s registration with the Exchange as a Security Futures Dealer.

##### Market Maker Categories

CBOT Regulation 431.07(c) 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 (CBOT Regulation 431.07(c)(1))

The market maker will provide continuous two-sided quotations throughout the trading day for all delivery months of security futures contracts representing a meaningful proportion of the total trading volume of security futures contracts on the Exchange,\* subject to relaxation during unusual market conditions as determined by the Exchange (such as a fast market in either a security futures contract or a security underlying a security futures contract) at which times the market maker must use its best efforts to quote continuously and competitively. The market maker must provide quotations for a minimum quantity of one (1) contract with a maximum bid/ask spread of no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the underlying security.

##### Category 2 (CBOT Regulation 431.07(c)(2))

The market maker will respond to at least 75% of the requests for quotation for all delivery months of security futures contracts representing a meaningful proportion of the total trading volume of security futures contracts on the Exchange,\* subject to relaxation during unusual market conditions as determined by the Exchange (such as a fast market in either a security futures contract or a security underlying a security futures contract) at which times the market maker must use its best efforts to quote competitively. When responding to requests for quotation, the market maker must quote within five seconds for a minimum quantity of one (1) contract with a maximum bid/ask spread of no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the underlying security.

##### Category 3 (CBOT Regulation 431.07(c)(3))

(i) The market maker will be assigned to a group of security futures contracts listed on the Exchange that is either unlimited in nature (“Unlimited Assignment”) or will be assigned to no more than 20% of the security futures contracts listed on the Exchange (“Limited Assignment”); and

(ii) At least 75% of the market maker’s total trading activity in CBOT

\* Beginning on the 181st calendar day after the commencement of trading of security futures contracts on the Exchange, a “meaningful proportion of the total trading volume of security futures contracts on the Exchange” will mean a minimum of 20% of such trading volume.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

security futures contracts must be in its assigned security futures contracts, measured on a quarterly basis; and

(iii) During at least 50% of the trading day, the market maker must have bids or offers in the market that are at or near the best market, except in unusual market conditions as determined by the Exchange (such as a fast market in either a security futures contract or a security underlying a security futures contract), with respect to at least 25% (in the case of an Unlimited Assignment) or at least one (1) (in the case of a Limited Assignment) of its assigned security futures contracts; and

(iv) The requirements in (ii) and (iii) must be satisfied on at least the following percentages of trading days in each calendar quarter:

(a) 90% (in the case of an Unlimited Assignment);

(b) 80% (in the case of a Limited Assignment); or

(c) 80% (in the case of either an Unlimited Assignment or a Limited Assignment if the Exchange is listing four or fewer security futures contracts).

#### 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 ("Code"), a member is required to:

(i) Register as a Security Futures Dealer for purposes of the Exchange's security futures margin rules under Category 1 or Category 2 above; and

(ii) Undertake in its registration form to provide quotations for all products specified for the market maker exclusion from the CBOT security futures margin rules; and

(iii) Quote a minimum size of:

(a) Ten (10) contracts for each security futures product not covered by (b) or (c) below;

(b) Five (5) contracts for each security futures 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 security 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 CBOT Security Futures Dealer Registration Form, a member must specify all CBOT security futures

contracts for which it intends to act as a market maker. The Exchange will assign to the member all of the security futures contracts listed, unless the CBOT provides written notice to the member identifying any security futures contracts for which such assignment is not being granted. A member may change the list of contracts for which it undertakes to act as a market maker for any calendar quarter by filing a revised CBOT Security Futures Dealer Registration Form with the Exchange on any business day prior to the last trading day of the quarter, and the change shall be effective retroactive to the first trading day of the 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 specified on its Registration Form with respect to all CBOT security futures contracts assigned for that calendar quarter.

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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 Exchange 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 Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

### A. Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

Pursuant to CBOT Rule 225.00, the Exchange has adopted a security futures market maker program under which an individual member or member firm (each referred to as a "member" herein) may be registered with the CBOT as a Security Futures Dealer<sup>3</sup> with respect to one or more security futures contracts traded on the Exchange to provide liquidity and orderliness in the market for such contracts. The proposed rule change sets forth the procedures necessary for members to be registered as CBOT Security Futures Dealers and

the policies that apply to such registration.

The proposed rule change restates the qualifications that members must meet under proposed CBOT Regulation 431.07 to qualify for the market maker exclusion from CBOT security futures customer margin requirements.<sup>4</sup> In addition, the proposed rule change reminds members that failure to comply with applicable CBOT rules or regulations or rules or regulations under the Act or the Commodity Exchange Act ("CEA") is subject to disciplinary action under Chapter 5 of the Exchange's Rulebook. The appropriate sanctions for any such failure include, without limitation, revocation of the market maker's registration as a CBOT Security Futures Dealer.

Under the proposed rule change, a member who wishes to be a security futures market maker entitled to exclusion from the security futures customer margin requirements must file a CBOT Security Futures Dealer Registration Form with the Exchange. The registration form requires members to identify all CBOT security futures contracts for which they are seeking assignment as market makers, as well as the qualifying market maker category under proposed CBOT Regulation 431.07(c). By signing the registration form, the member confirms that it meets and will continue to meet the requirements to act as a security futures market maker under the Exchange's rules. The registration form requires members to list all CBOT security futures contracts for which they will act as market makers. The registration form also requires a member to identify the qualifying market maker category under proposed CBOT Regulation 431.07(c).<sup>5</sup>

The proposed rule change establishes that the Exchange will assign to the member all security futures contracts listed on its registration form, unless the Exchange provides written notice to the member identifying any security futures contracts for which such assignment is not being granted. Under the proposed rule change, for any calendar quarter, a market maker may change the list of security futures contracts to which it is assigned by filing a revised CBOT Security Futures Dealer Registration Form prior to the last trading day in the calendar quarter. Such change in contract designation will be effective

<sup>4</sup> See *id.*

<sup>5</sup> Under proposed CBOT Regulation 431.07(c), there are three alternative ways for a member to satisfy the requirement that a 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. See Customer Margin Requirements Approval Order, *supra* note 3.

<sup>3</sup> A Security Futures Dealer is defined in proposed CBOT Regulation 431.07, which is the subject of SR-CBOT-2006-01. The Commission is today approving SR-CBOT-2006-01. See Securities Exchange Act Release No. 53626 ("Customer Margin Requirements Approval Order").

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 specified on its registration form for all assigned security futures contracts for that quarter. Specifically, the proposal states that a security futures market maker must maintain records sufficient to prove compliance with the requirements set forth in proposed CBOT Regulation 431.07 and applicable regulations under the Act and the CEA, including without limitation, trading account statements and other financial records sufficient to detail activity.

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 1986, as amended ("Code").<sup>6</sup> Under the proposed rule change, to qualify as a dealer within the meaning of the Code, a member must: (i) Register as a CBOT Security Futures Dealer for purposes of the Exchange's security futures customer margin rules under Category 1 or Category 2 (proposed CBOT Regulation 431.07(c)(1) or (c)(2)); (ii) undertake in its registration form to provide quotations for all contracts specified for the market maker exclusion from the Exchange's security futures customer margin rules; and (iii) quote a minimum size of:

(a) Ten (10) contracts for each security futures product not covered by (b) or (c) below;

(b) Five (5) contracts for each security futures product specified by the market maker 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 security 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.<sup>7</sup>

## 2. Statutory Basis

The CBOT believes that the proposal is consistent with section 6(b) of the Act,<sup>8</sup> in general, and section 6(b)(5) of the Act,<sup>9</sup> 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 security futures market maker program, which, according to the Exchange, are designed to provide liquidity and orderliness in the markets for CBOT security futures contracts. Thus, the CBOT believes that the proposed rule change promotes just and equitable principles of trade and protects investors and the public interest.

### B. Statement of Burden on Competition

The CBOT 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. Comments on the Proposed Rule Change Received From Members, Participants, or Others

The Exchange has not solicited or received any written comments regarding the proposed rule change, nor will any such comments be solicited.

## 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOT-2006-02 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOT-2006-02. 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. Copies of such filing also will be available for inspection and copying at the principal office of the CBOT. All comments received will be posted without change; the Commission does not edit identifying personal information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-CBOT-2006-02 and should be submitted on or before May 8, 2006.

## IV. Commission Findings and Order Granting Accelerated Approval of 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.<sup>10</sup> In particular, the Commission believes that the proposed rule change is consistent with the requirements of section 6(b)(5) of the Act,<sup>11</sup> which requires, among other things, that the rules of the Exchange be designed to promote just and equitable principles of trade and, in general, to protect investors and the public interest. In addition, the Commission believes that the proposed rule change is consistent with section 7(c)(2)(B) of the Act,<sup>12</sup> which provides, among other things, that the margin requirements for securities 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,<sup>13</sup> which permits a national securities exchange to adopt rules containing specific 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.<sup>14</sup> The Commission believes that the proposed obligations for market makers satisfy this requirement. Specifically, the

<sup>10</sup> 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).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> 15 U.S.C. 78g(c)(2)(B).

<sup>13</sup> 17 CFR 242.400(c)(2)(v).

<sup>14</sup> 15 U.S.C. 78g(c)(2)(B).

<sup>6</sup> 26 U.S.C. 1256(g)(9).

<sup>7</sup> 7 U.S.C. 1a(25).

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

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 CBOT market.

The CBOT 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 requirement for "60/40" tax treatment are an extension of the obligations adopted in connection with the CBOT's customer margin rules, which set forth the standards under which a CBOT 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.<sup>15</sup> Furthermore, the Commission notes that the proposed rule change is substantially similar to OneChicago, LLC's market maker registration policy and procedures, which were approved by the Commission. Accordingly, the Commission finds good cause, consistent with section 19(b)(2) of the Act,<sup>16</sup> 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 Act<sup>17</sup> that the proposed rule change (SR-CBOT-2006-02) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Nancy M. Morris,**

*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-53626; File No. SR-CBOT-2006-01]

### Self-Regulatory Organizations; Board of Trade of the City of Chicago, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to Customer Margin Requirements for Security Futures

April 10, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on March 2, 2006, the Board of Trade of the City of Chicago, Inc. ("CBOT" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposed rule change.

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

The Exchange is proposing to establish procedures relating to the determination and administration of customer margin for security futures positions established on the Exchange and maintained in futures accounts. Further, the proposed regulations define the applicability of these requirements, specifically excluding qualifying security futures dealers from customer security futures margin requirements and related regulatory requirements. The text of the proposed rule change is below. New text is italicized.

\* \* \* \* \*

#### *New Regulation 431.07 Customer Margins for Security Futures Positions Held in Futures Accounts*

*Margin requirements associated with Security Futures positions, which result from transactions made on the Exchange on behalf of Customers, and which are held in a futures account, shall be determined and administered in accordance with the Rules and Regulations of the Exchange, and in compliance with CFTC Regulations 41.42 through 41.49 and SEC Regulations 242.400 through 242.406. With regard to such Security Futures*

*positions, if Exchange Rules or Regulations are inconsistent with CFTC Regulations 41.42 through 41.49 and SEC Regulations 242.400 through 242.406, including any successor Regulations, the CFTC and SEC Regulations shall prevail.*

*(a) Initial and maintenance margin rates used in determining Exchange margin requirements applicable to Security Futures that are held on behalf of Customers in a futures account, shall be established at levels no lower than those prescribed by CFTC Regulation 41.45 and SEC Regulation 242.403, including any successor Regulations.*

*(b) As used in this Regulation, the term "Customer" does not include (a) an "exempted person" as defined in CFTC Regulation 41.43(a)(9) and SEC Regulation 242.401(a)(9); or (b) Market Makers as defined below.*

*(c) A Person shall be a "Market Maker" for purposes of this Rule, and shall be excluded from the requirements set forth in CFTC Regulations 41.42 through 41.49 and SEC Regulations 242.400 through 242.406, as applicable, in accordance with CFTC Regulation 41.42(c)(2)(v) and SEC Regulation 242.400(c)(2)(v), with respect to all trading in Security Futures for its own account, if such Person is an Exchange Member that is registered with the Exchange as a "Security Futures Dealer."*

*Each such Market Maker shall: (a) be a member of the Exchange and be registered as a floor trader or a floor broker with the CFTC under Section 4f(a)(1) of the CEA or be registered as a dealer with the SEC under Section 15(b) of the Exchange Act; (b) maintain records sufficient to prove compliance with the requirements set forth in this Regulation and CFTC Regulation 41.42(c)(2)(v) or SEC Regulation 242.400(c)(2)(v), as applicable, including without limitation, trading account statements and other financial records sufficient to detail activity; and (c) hold itself out as being willing to buy and sell Security Futures for its own account on a regular or continuous basis.*

*A Market Maker satisfies condition (c) above if any of the following three requirements are fulfilled:*

*(1) The Market Maker:*

*(i) Provides continuous two-sided quotations throughout the trading day for all delivery months of Security Futures Contracts representing a meaningful proportion of the total trading volume of Security Futures Contracts on the Exchange, subject to relaxation during unusual market conditions as determined by the Exchange (such as a fast market in*

<sup>15</sup> See Securities Exchange Act Release No. 50115 (July 29, 2004) 69 FR 48261 (August 9, 2004).

<sup>16</sup> 15 U.S.C. 78s(b)(2).

<sup>17</sup> *Id.*

<sup>18</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.