

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53626; File No. SR-CBOT-2006-01)

April 10, 2006

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

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),¹ and Rule 19b-4 thereunder,² 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 underlined.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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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 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; and

(ii) When providing quotations, quotes 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 security underlying each Security Futures Contract.

(2) The Market Maker:

(i) Responds 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; and

(ii) When responding to requests for quotation, quotes within five seconds 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 security underlying each Security Futures Contract.

(3) The Market Maker:

(i) Is assigned to a group of Security Futures Contracts listed on the Exchange that is either unlimited in nature (“Unlimited Assignment”) or is 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 Exchange Security Futures Contracts is in its assigned Security Futures Contracts, measured on a quarterly basis; and
- (iii) During at least 50% of the trading day, the 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 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 (in the case of a Limited Assignment) of its assigned Security Futures Contracts; and
- (iv) The requirements in (ii) and (iii) are satisfied on (a) at least 90% of the trading days in each calendar quarter by Market Makers who have undertaken an Unlimited Assignment; or (b) at least 80% of the trading days in each calendar quarter by Market Makers who have undertaken a Limited Assignment; or (c) on at least 80% of the trading days in each calendar quarter by Market Makers who have undertaken either an Unlimited Assignment or Limited Assignment but where the Exchange is listing four (4) or fewer Security Futures Contracts.

For purposes of clauses (1) and (2) above, 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” shall mean a minimum of 20% of such trading volume.

Any Market Maker that fails to comply with the applicable Rules of the Exchange, CFTC Regulations 41.42 through 41.49 or SEC Regulations 242.400 through 242.406, as applicable, shall be subject to disciplinary action in accordance with Chapter 5. Appropriate sanctions in the case of any such failure shall include, without limitation, a revocation of such Market Maker’s registration with the Exchange as a Security Futures Dealer.

(d) The Exchange shall establish initial and maintenance margin requirements applicable to Security Futures that are held in a futures account, provided that the margin requirement for any long or short position held by a member firm on behalf of a Customer shall not be less than 20% of the current market value of the relevant Security Futures Contract, or such other requirement as may be established by the CFTC and SEC for purposes of CFTC Regulation 41.45(b)(1) and SEC Regulation 242.403(b)(1), unless a lower margin level is available for such position pursuant to paragraph (e) below.

(e) Initial and maintenance margin requirements for offsetting positions involving Security Futures and related positions are provided in the schedule below, for purposes of CFTC Regulation 41.45(b)(2) and SEC Regulation 242.403(b)(2).

Margin Requirements for Offsetting Positions

1	<u>Long security future (or basket of security futures representing each component of a narrow-based securities index³) and long put option⁴ on the same underlying security (or index)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the long security future, plus pay for the long put in full.</u>	<u>The lower of: (1) 10% of the aggregate exercise price⁵ of the put plus the aggregate put out-of-the-money⁶ amount, if any; or (2) 20% of the current market value of the long security future.</u>
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³ Baskets of securities or security futures contracts must replicate the securities that comprise the index, and in the same proportion.

⁴ Generally, for the purposes of these regulations, unless otherwise specified, stock index warrants shall be treated as if they were index options.

⁵ “Aggregate exercise price,” with respect to an option or warrant based on an underlying security, means the exercise price of an option or warrant contract multiplied by the numbers of units of the underlying security covered by the option contract or warrant. “Aggregate exercise price” with respect to an index option, means the exercise price multiplied by the index multiplier. See, e.g., Amex Rules 900 and 900C; CBOE Rule 12.3; and NASD Rule 2522.

⁶ “Out-of-the-money” amounts shall be determined as follows:
(1) for stock call options and warrants, any excess of the aggregate exercise price of the option or warrant over its current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System);

(2) for stock put options or warrants, any excess of the current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System) of the option or warrant over its aggregate exercise price;

(3) for stock index call options and warrants, any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable index multiplier; and

(4) for stock index put options and warrants, any excess of the product of the current index value and the applicable index multiplier over the aggregate exercise price of the option or warrant. See, e.g., NYSE Rule 431 (Exchange Act Release No. 42011 (October 14, 1999), 64 FR 57172 (October 22, 1999) (order approving SR-NYSE-99-03)); Amex Rule 462 (Exchange Act Release No. 43582 (November 17, 2000), 65 FR 71151 (November 29, 2000) (order approving SR-Amex-99-27)); CBOE Rule 12.3 (Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999) (order approving SR-CBOE-97-67)); or NASD Rule 2520 (Exchange Act Release No. 43581 (November 17, 2000), 65 FR 70854 (November 28, 2000) (order approving SR-NASD-00-15)).

2	<u>Short security future (or basket of security futures representing each component of a narrow-based securities index) and short put option on the same underlying security (or index)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any. Proceeds from the put sale may be applied.</u>	<u>20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any.⁷</u>
3	<u>Long security future and short position in the same security (or securities basket) underlying the security future</u>	<u>Individual stock or narrow-based security index</u>	<u>The initial margin required under Regulation T for the short stock or stocks.</u>	<u>5% of the current market value as defined in Regulation T of the stock or stocks underlying the security future.</u>
4	<u>Long security future (or basket of security futures representing each component of a narrow-based securities index) and short call option on the same underlying security (or index)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any. Proceeds from the call sale may be applied.</u>	<u>20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any.</u>

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“In-the-money” amounts must be determined as follows:

(1) for stock call options and warrants, any excess of the current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System) of the option or warrant over its aggregate exercise price;

(2) for stock put options or warrants, any excess of the aggregate exercise price of the option or warrant over its current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System);

(3) for stock index call options and warrants, any excess of the product of the current index value and the applicable index multiplier over the aggregate exercise price of the option or warrant; and

(4) for stock index put options and warrants, any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable index multiplier.

5	<u>Long a basket of narrow-based security futures that together tracks a broad-based index and short a broad-based security index call option contract on the same index</u>	<u>Narrow-based security index</u>	<u>20% of the current market value of the long basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any. Proceeds from the call sale may be applied.</u>	<u>20% of the current market value of the long basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any.</u>
6	<u>Short a basket of narrow-based security futures that together tracks a broad-based security index and short a broad-based security index put option contract on the same index</u>	<u>Narrow-based security index</u>	<u>20% of the current market value of the short basket of narrow-based security futures, plus the aggregate put in-the-money amount, if any. Proceeds from the put sale may be applied.</u>	<u>20% of the current market value of the short basket of narrow-based security futures, plus the aggregate put in-the-money amount, if any.</u>
7	<u>Long a basket of narrow-based security futures that together tracks a broad-based security index and long a broad-based security index put option contract on the same index</u>	<u>Narrow-based security index</u>	<u>20% of the current market value of the long basket of narrow-based security futures, plus pay for the long put in full.</u>	<u>The lower of: (1) 10% of the aggregate exercise price of the put, plus the aggregate put out-of-the-money amount, if any; or (2) 20% of the current market value of the long basket of security futures.</u>
8	<u>Short a basket of narrow-based security futures that together tracks a broad-based security index and long a broad-based security index call option contract on the same index</u>	<u>Narrow-based security index</u>	<u>20% of the current market value of the short basket of narrow-based security futures, plus pay for the long call in full.</u>	<u>The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 20% of the current market value of the short basket of security futures.</u>

9	<u>Long security future and short security future on the same underlying security (or index)</u>	<u>Individual stock or narrow-based security index</u>	<u>The greater of: 5% of the current market value of the long security future; or (2) 5% of the current market value of the short security future.</u>	<u>The greater of: 5% of the current market value of the long security future; or (2) 5% of the current market value of the short security future.</u>
10	<u>Long security future, long put option and short call option. The long security future, long put and short call must be on the same underlying security and the put and call must have the same exercise price. (Conversion)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from the call sale may be applied.</u>	<u>10% of the aggregate exercise price, plus the aggregate call in-the-money amount, if any.</u>
11	<u>Long security future, long put option and short call option. The long security future, long put and short call must be on the same underlying security and the put exercise price must be below the call exercise price (Collar)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from call sale may be applied.</u>	<u>The lower of: (1) 10% of the aggregate exercise price of the put plus the aggregate put out-of-the money amount, if any; or (2) 20% of the aggregate exercise price of the call, plus the aggregate call in-the-money amount, if any.</u>
12	<u>Short security future and long position in the same security (or securities basket) underlying the security future</u>	<u>Individual stock or narrow-based security index</u>	<u>The initial margin required under Regulation T for the long stock or stocks.</u>	<u>5% of the current market value, as defined in Regulation T, of the long stock or stocks.</u>
13	<u>Short security future and long position in a security immediately convertible into the same security underlying the security future, without restriction, including the payment of money</u>	<u>Individual stock or narrow-based security index</u>	<u>The initial margin required under Regulation T for the long security.</u>	<u>10% of the current market value, as defined in Regulation T, of the long security.</u>

14	<u>Short security future (or basket of security futures representing each component of a narrow-based securities index) and long call option or warrant on the same underlying security (or index)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the short security future, plus pay for the call in full.</u>	<u>The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 20% of the current market value of the short security future.</u>
15	<u>Short security future, short put option and long call option. The short security future, short put and long call must be on the same underlying security and the put and call must have the same exercise price. (Reverse Conversion)</u>	<u>Individual stock or narrow-based security index</u>	<u>20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any, plus pay for the call in full. Proceeds from put sale may be applied.</u>	<u>10% of the aggregate exercise price, plus the aggregate put in-the-money amount, if any.</u>
16	<u>Long (short) a basket of security futures, each based on a narrow-based security index that together tracks the broad-based index and short (long) a broad-based index future</u>	<u>Narrow-based security index</u>	<u>5% of the current market value for the long (short) basket of security futures.</u>	<u>5% of the current market value of the long (short) basket of security futures.</u>
17	<u>Long (short) a basket of security futures that together tracks a narrow-based index and short (long) a narrow-based index future</u>	<u>Individual stock or narrow-based security index</u>	<u>The greater of: (1) 5% of the current market value of the long security future(s); or (2) 5% of the current market value of the short security future(s).</u>	<u>The greater of: (1) 5% of the current market value of the long security future(s); or (2) 5% of the current market value of the short security future(s).</u>

18	<u>Long (short) a security future and short (long) an identical security future traded on a different market.</u> ⁸	<u>Individual stock or narrow-based security index</u>	<u>The greater of: (1) 3% of the current market value of the long security future(s); or (2) 3% of the current market value of the short security future(s).</u>	<u>The greater of: (1) 3% of the current market value of the long security future(s); or (2) 3% of the current market value of the short security future(s).</u>
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New Regulation 431.08 Acceptable Margin for Security Futures and Treatment of Undermargined Accounts

Notwithstanding any other Exchange Rules or Regulations, the following provisions shall establish the acceptable margin for Security Futures Positions that are held on behalf of Customers in a futures account, and the treatment of undermargined futures accounts containing Security Futures Contracts.

(a) Member firms may accept from their Customers as margin for Security Futures held in a futures account, deposits of cash, margin securities (subject to the limitations set forth in the following sentence), exempted securities, any other assets permitted under Regulation T of the Board of Governors of the Federal Reserve System (as in effect from time to time) to satisfy a margin deficiency in a securities margin account, and any combination of the foregoing, each as valued in accordance with CFTC Regulations 41.46(c) and 41.46(e) or SEC Regulations 242.404(c) and 242.404(e), as applicable. Shares of a money market mutual fund

⁸ Two security futures will be considered “identical” for this purpose if they are issued by the same clearing agency or cleared and guaranteed by the same derivatives clearing organization, have identical contract specifications, and would offset each other at the clearing level.

that meet the requirements of CFTC Regulation 1.25 may be accepted as a margin deposit from a Customer for purposes of this Rule.

(b) A member firm shall not accept as margin from any Customer securities that have been issued by such Customer or an Affiliate of such Customer unless such member firm files a petition with and receives permission from the Exchange for such purpose.

(c) All assets deposited by a Customer to meet margin requirements must be and remain unencumbered by third party claims against the depositing Customer.

(d) If a Customer fails to comply with a margin call within a reasonable period of time (the member firm may deem one hour to be a reasonable period of time), the relevant member firm shall take the deduction required with respect to an undermargined account in computing its net capital under applicable CFTC and SEC Regulations.

(e) If at any time there is a liquidating deficit in an account in which Security Futures are held, the member firm shall take steps to liquidate positions in the account promptly and in an orderly manner.

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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. The text of these statements may be examined at the places specified in Item III below. The Exchange 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

Proposed Regulation 431.07 generally establishes that the determination and administration of customer margins shall be consistent with prevailing practices on the Exchange. To the extent, however, that Exchange practices may be inconsistent with Commodity Futures Trading Commission (“CFTC”) Regulations 41.42 through 41.49⁹ or SEC Regulations 242.400 through 242.406,¹⁰ as applicable, the CFTC and SEC Regulations shall prevail.

General Applicability – Proposed Regulation 431.07 only applies to security futures transactions executed on the CBOT. To the extent that security futures intermediaries engage in security futures transactions on or through other exchanges, they will need to comply with the margin requirements established by those other exchanges with respect to such transactions. In addition, proposed Regulation 431.07 only applies to transactions made on behalf of “Customers” as defined in paragraph (b) of the proposed Regulation. Furthermore, proposed Regulation 431.07 is applicable only to security futures positions held in futures accounts. While security futures may alternatively be held in a securities account, the administration of securities accounts will be governed by applicable regulations, and by rules adopted by other relevant self-regulatory organizations.

Proposed Regulation 431.07(b) excludes “exempted persons” and “Market Makers” from the definition of “Customer.” Therefore, the transactions of exempted persons and Market Makers are not subject to the customer margin requirements set forth

⁹ 17 CFR 41.42 - 41.49.

¹⁰ 17 CFR 242.400 - 406.

in proposed Regulation 431.07. Exempted persons are identified by reference to applicable CFTC and SEC Regulations and Market Makers are defined as described below.

Market Maker Exclusion - CFTC Regulation 41.42(c)(2)(v)¹¹ and SEC Regulation 242.400(c)(2)(v)¹² permit exchanges to adopt rules containing specified requirements for security futures dealers, on the basis of which the financial relations between security futures intermediaries and qualifying security futures dealers are excluded from the customer margin requirements for security futures. Any rules so adopted by an exchange must meet the criteria set forth in Section 7(c)(2)(B) of the Exchange Act.¹³

Proposed Regulation 431.07(c) relies on CFTC Regulation 41.42(c)(2)(v)¹⁴ and SEC Regulation 242.400(c)(2)(v)¹⁵ in establishing a Market Maker exclusion. In particular, CBOT members who meet certain qualifications would be permitted to register with the Exchange as Security Futures Dealers, such that their accounts would not be subject to customer security futures margin requirements. Rather, their accounts would be subject to security futures margin requirements established pursuant to proposed Regulation 431.07(d).

¹¹ 17 CFR 41.42(c)(2)(v).

¹² 17 CFR 242.400(c)(2)(v).

¹³ 15 U.S.C. 78g(c)(2)(B).

¹⁴ 17 CFR 41.42(c)(2)(v).

¹⁵ 17 CFR 242.400(c)(2)(v).

Market Makers will be floor traders or floor brokers registered with the CFTC under Section 4f(a)(1) of the Commodity Exchange Act, as amended (“CEA”),¹⁶ or dealers registered with the SEC under Section 15(b) of the Exchange Act.¹⁷ As such, they may not qualify as exempted persons within the meaning of Regulation 242.401(a)(9) under the Exchange Act.¹⁸ Absent the provisions of proposed Regulation 431.07, they arguably would have to be treated as customers for purposes of determining margin requirements, even with respect to their proprietary market making activities. This would be different from the treatment of security futures dealers on securities exchanges under Section 7(c)(3) of the Exchange Act,¹⁹ and therefore would be contrary to the statutory objectives reflected in Section 7(c)(2)(B) of the Exchange Act.²⁰

The Market Maker exclusion, as proposed, contains all of the criteria and limitations set forth in CFTC Regulation 41.42(c)(2)(v)²¹ and SEC Regulation 242.400(c)(2)(v),²² including a clause that requires 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.” In the release on Customer Margin Rules Relating to Security Futures

¹⁶ 7 U.S.C. 6f(a)(1).

¹⁷ 15 U.S.C. 78(o)(b).

¹⁸ 17 CFR 242.401(a)(9).

¹⁹ 15 U.S.C. 78g(c)(3).

²⁰ 15 U.S.C. 78g(c)(2)(B).

²¹ 17 CFR 41.42(c)(2)(v).

²² 17 CFR 242.400(c)(2)(v).

(“Customer Margin Release”),²³ the Commission and the CFTC identified three alternate means by which to demonstrate such willingness, as follows:

1. An exchange may require market makers to effect a certain percentage of their security futures trades with persons other than those registered as market makers;
2. Market makers could be subject to rules that impose an affirmative obligation to quote on a regular or continuous basis; or
3. An exchange may require that a “large majority” of a market maker’s revenue be derived from trading listed financial based derivatives including futures and options on stocks, stock indexes, foreign currencies, and interest rate instruments.

The CBOT generally proposes to apply the second standard listed above, which includes affirmative obligations to make markets. Specifically, under proposed Regulation 431.07(c), a Market Maker is considered willing to hold itself out to buy and sell security futures on a continuous or regular basis if it fulfills any one of three tests.

The first test, set forth in Regulation 431.07(c)(1), requires a Market Maker to provide:

. . . continuous two-sided quotations throughout the trading day for all delivery months of [specified] Security Futures Contracts . . . and . . . [quote] . . . with a maximum bid/ask spread no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying each Security Futures Contract.

²³ Exchange Act Release No. 46292 (August 1, 2002), 67 FR 53146 (August 14, 2002).

The second test, set forth in Regulation 431.07(c)(2), requires a Market Maker to respond:

. . . to at least 75% of the requests for quotation for all delivery months of [specified] Security Futures Contracts . . . and . . . [w]hen responding to requests for quotation, [quote] within five seconds with a maximum bid/ask spread no more than the greater of \$0.20 or 150% of the bid/ask spread in the primary market for the security underlying each Security Futures Contract.

The first and second tests require Market Makers to be assigned to a meaningful proportion of Security Futures Contracts listed on the Exchange. A “meaningful proportion” is defined in proposed Regulation 431.07(c) to refer to Security Futures Contracts that represent at least 20% of the total Security Futures Contract trading volume on the Exchange after the 181st calendar day subsequent to the commencement of trading in Security Futures Contracts on the Exchange.

The third test, set forth in Regulation 431.07(c)(3), requires that a Market Maker must be:

. . . assigned to a group of Security Futures Contracts listed on the Exchange that is either unlimited in nature (“Unlimited Assignment”) or is assigned to no more than 20% of the Security Futures Contracts listed on the Exchange (“Limited Assignment”); and . . . [a]t least 75% of the Market Maker's total trading activity in Exchange Security Futures Contracts is in its assigned Security Futures Contracts, measured on a quarterly basis; and . . . [d]uring at least 50% of the trading day, the Market Maker has bids or offers in the market that are at or near the best market . . . with respect to at least 25% (in the case of an Unlimited

Assignment) or at least one (in the case of a Limited Assignment) of its assigned Security Futures Contracts; and . . . [these obligations must be] satisfied on (a) at least 90% of the trading days in each calendar quarter by Market Makers who have undertaken an Unlimited Assignment; or (b) at least 80% of the trading days in each calendar quarter by Market Makers who have undertaken a Limited Assignment; or (c) on at least 80% of the trading days in each calendar quarter . . . where the Exchange is listing four (4) or fewer Security Futures Contracts.

Market Makers are required to maintain books and records in order to evidence compliance with these standards. This recordkeeping requirement includes, without limitation, trading account statements and other financial records necessary to detail Market Maker activity. Failure on the part of a Market Maker to comply with these standards may result in revocation of the Market Maker's registration with the Exchange as a Security Futures Dealer, or other sanctions under CBOT Rules and Regulations.

The CBOT believes that proposed Regulation 431.07(b) and (c) are consistent with the requirements of the Exchange Act and with the explanations accompanying the publication of those requirements.

Margin Rates - Proposed Regulation 431.07(a) requires that customer margin rates be established at levels no lower than those prescribed by CFTC Regulation 41.45²⁴ and SEC Regulation 242.403.²⁵ Proposed Regulation 431.07(d) specifically provides that the margin level for each long or short position in a Security Futures contract held on behalf of a customer shall not be less than 20% of the current market value of such

²⁴ 17 CFR 41.45.

²⁵ 17 CFR 242.403.

Security Futures contract, as required by SEC Regulation 242.403(b)(1)²⁶ and CFTC Regulation 41.45(b)(1).²⁷

Exceptions to the 20% requirement are established under proposed Regulation 431.07(e). These exceptions rely upon SEC Regulation 242.403(b)(2)²⁸ and CFTC Regulation 41.45(b)(2)²⁹ that provide that a self-regulatory authority may set the required initial or maintenance margin level for offsetting positions involving security futures and related positions at a level lower than the level that would apply if margin requirements for such positions were calculated separately based on the 20% requirement, provided that the rules establishing such lower margin levels meet the criteria set forth in Section 7(c)(2)(B) of the Exchange Act.³⁰ That Section requires that:

- (I) The margin requirements for a security futures product be consistent with the margin requirements for comparable option contracts traded on any exchange registered pursuant to Section 6(a) of [the Exchange Act]; and
- (II) Initial and maintenance margin levels for a security futures product not be lower than the lowest level of margin, exclusive of premium, required for any comparable option contract traded on any exchange

²⁶ 17 CFR 242.403(b)(1).

²⁷ 17 CFR 41.45(b)(1).

²⁸ 17 CFR 242.403(b)(2).

²⁹ 17 CFR 41.45(b)(2).

³⁰ 15 U.S.C. 78g(c)(2)(B).

registered pursuant to Section 6(a) of [the Exchange Act], other than an option on a security future.

Absent the margin relief afforded by proposed Regulation 431.07(e), security futures intermediaries would be required to collect margin from their customers equal to at least 20% of the current market value of the security futures held on behalf of such customers, even if such security futures positions were hedged. With respect to option contracts traded on securities exchanges, the Commission has recognized that it is appropriate for the SROs to recognize the hedged nature of certain combined options strategies and prescribe margin requirements that better reflect the risk of those strategies.³¹

The CBOT believes that the same considerations apply in connection with the determination of margin levels for offsetting positions involving security futures and related positions. If margin offsets were not available with respect to security futures, the customer margin requirements applicable to such instruments would effectively be inconsistent with, and more onerous than, the margin requirements for comparable option contracts traded on securities exchanges. This would be contrary to the statutory objectives reflected in Section 7(c)(2)(B) of the Exchange Act.³²

³¹ See Exchange Act Release Nos. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999)(order approving SR-CBOE-97-67 amending CBOE Rule 12.3); 42011 (October 14, 1999)(order approving SR-NYSE-99-03 amending NYSE Rule 431); 43582 (November 17, 2000), 65 FR 70854 (November 28, 2000)(order approving SR-Amex-99-27 amending Amex Rule 462); and 43581 (November 17, 2000), 65 FR 71151 (November 29, 2000)(order approving SR-NASD-00-15 amending NASD Rule 2520).

³² 15 U.S.C. 78g(c)(2)(B).

Proposed Regulation 431.07(e) incorporates a schedule which describes in detail the margin offsets available with respect to particular combinations of security futures and related positions. This schedule is substantively identical to the table of offsets included in the Customer Margin Release. While the table differs in certain respects from similar tables in effect for exchange-traded options, the Commission acknowledged in its Customer Margin Release that these limited differences are warranted by different characteristics of the instruments to which they relate. Accordingly, the CBOT believes that proposed Regulation 431.07(e) is consistent with the requirements of the Exchange Act and the Rules and Regulations thereunder.

Margin Administration - Proposed Regulation 431.08(a) identifies the types of instruments that a security futures intermediary may accept from a customer as margin for security futures positions held in a futures account. Consistent with SEC Regulation 242.404(b)³³ and CFTC Regulation 41.46(b),³⁴ acceptable types of margin are limited to deposits of cash, margin securities (subject to specified restrictions), exempted securities, any other assets permitted under Regulation T³⁵ of the Board of Governors of the Federal Reserve System to satisfy a margin deficiency in a securities margin account, and any combination of the foregoing. Proposed Regulation 431.08(a) further provides that the different types of eligible margin deposits are to be valued in accordance with the

³³ 17 CFR 242.404(b).

³⁴ 17 CFR 41.46(b).

³⁵ 12 CFR 220.1 et seq.

applicable principles set forth in SEC Regulations 242.404(c) and 242.404(e)³⁶ and CFTC Regulations 41.46(c) and 41.46(e).³⁷

Proposed Regulation 431.08(d) requires a security futures intermediary to take the deduction required with respect to an undermargined account in computing its net capital under applicable SEC and CFTC Regulations if the customer has failed to comply with a required margin call within a reasonable period of time. This requirement is consistent with SEC Regulation 242.406(a)³⁸ and CFTC Regulation 41.48(a).³⁹ Further, proposed Regulation 431.08(e) requires the liquidation of an account in which security futures are held where there is a liquidating deficit, in accordance with SEC Regulation 242.406(b)⁴⁰ and CFTC Regulation 41.48(b).⁴¹

The Exchange Act Regulations and related provisions of the Exchange Act are premised on each self-regulatory organization adopting margin requirements that are functionally equivalent to proposed CBOT Regulations 431.07 and 431.08. Accordingly, proposed Regulations 431.07 and 431.08 represent a corollary of, and are designed to give effect to, the Exchange Act Regulations and related provisions of the Exchange Act.

³⁶ 17 CFR 242.404(c) and 242.404(e).

³⁷ 17 CFR 41.46(c) and 41.46(e).

³⁸ 17 CFR 242.406(a).

³⁹ 17 CFR 41.48(a).

⁴⁰ 17 CFR 242.406(b).

⁴¹ 17 CFR 41.48(b).

B. Self-Regulatory Organization's Statement on 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. Self-Regulatory Organization's Statement on Comments on the Proposed RuleChange Received from Members, Participants or Others

The Exchange has neither solicited nor received written comments on 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 Exchange 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 e-mail to rule-comments@sec.gov. Please include File Number SR-CBOT-2006-01 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-2006-01. 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 Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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 submission should refer to File Number SR-CBOT-2006-01 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.⁴² In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,⁴³ 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

⁴² In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁴³ 15 U.S.C. 78f(b)(5).

Section 7(c)(2)(B) of the Act,⁴⁴ 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 the customer margin rules set forth in Rules 400 through 406 under the Act.⁴⁵

The Exchange has requested that the Commission approve this proposed rule change prior to the thirtieth day after publication of notice of the filing in the Federal Register. The Commission believes that nothing in this proposed rule change raises any new, unique, or substantive issues from those previously raised in SR-OC-2002-01, as amended, and SR-CME-2002-01, as amended⁴⁶ which rule filings set forth OneChicago's and the Chicago Mercantile Exchange's ("CME") margin requirements for security futures, respectively. The Exchange's proposed rules set forth herein are substantively identical to the parallel provisions in OneChicago Rule 515 and CME Rule 930. The Exchange noted that that OneChicago Rule 515(a) specifies that its market maker exclusion applies to security futures positions held in securities accounts, as well as those held in futures accounts. The proposed margin rules only address security futures positions held in futures accounts. Further, the offsets proposed by CBOT are consistent with the strategy-based offsets permitted for comparable offset positions involving exchange-traded options and therefore consistent with Section 7(c)(2)(B) of the Exchange

⁴⁴ 15 U.S.C. 78g(c)(2)(B).

⁴⁵ 17 CFR 242.400 - 406.

⁴⁶ See also SR-CME-2003-01 (approving, on a permanent basis, a standard under which a market maker can qualify for exclusion from CME's margin rules).

Act.⁴⁷ Finally, approval of the proposed rule change is necessary for CBOT to begin trading security futures.

Accordingly, the Commission finds good cause for approving this proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. Specifically, the Commission believes that it is consistent with Section 19(b)(2) of the Act⁴⁸ to approve the Exchange's 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,⁴⁹ that the proposed rule change (File No. SR-CBOT-2006-01) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵⁰

Nancy M. Morris
Secretary

⁴⁷ 15 U.S.C. 78g(c)(2)(B).

⁴⁸ 15 U.S.C. 78s(b)(2).

⁴⁹ Id.

⁵⁰ 17 CFR 200.30-3(a)(12).