

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49184; File No. SR-CBOE-2003-55]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. To Amend Provisions of Its Constitution and Rules Pertaining to the Governance of the Exchange

February 4, 2004.

#### I. Introduction

On November 19, 2003, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend provisions of CBOE's Constitution and rules pertaining to the governance of the Exchange. On December 11, 2003, CBOE submitted Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the *Federal Register* on December 29, 2003.<sup>3</sup> No comments were received on the proposed rule change. This order approves the proposed rule change, as amended.

#### II. Description of the Amended Proposal

##### *Terms of Office of Directors and Vice Chairman*

The proposed rule change will amend CBOE Constitution Sections 6.1(b), 6.4, and 8.1 to specify that Directors and the Vice Chairman take office on January 1. Currently, the term of office of Directors starts at the first regular meeting of the Board held after January 1 following the annual election, while the Vice Chairman's term starts on the 3rd Friday in December of each year. The proposal also amends CBOE Constitution Section 6.3(b) to provide the later of 45 days or until the next regular Board meeting for a Director who fails to maintain qualifications for a designated category to requalify. During any period in which a Director fails to maintain qualifications for a designated category, the Director shall be deemed not to hold office and the seat formerly held by the Director shall be deemed vacant for all purposes.

##### *CBOE's Nominating Committee*

The proposal amends CBOE Constitution Section 4.1(b) to allow a member of the Nominating Committee who was elected to a term of less than three years as a result of a vacancy to stand for reelection. The proposal also deletes from CBOE Constitution Section 4.3 the requirements that the Nominating Committee hold three meetings in October, and that it announce its slate of candidates no later than October 10th or the first business day thereafter if October 10th is not a business day. In addition, the proposal adopts new CBOE Constitution Section 4.8 to require that members of the Nominating Committee continuously meet the eligibility criteria for the category to which they were elected. New Constitution Section 4.8 also specifies that the Board of Directors alone determines whether a Nominating Committee member satisfies the qualification criteria for the category to which he or she was elected and that a member of the Nominating Committee who fails to maintain the applicable qualifications has 45 days from the date the Board determines the member is not qualified to requalify. During any period in which a member of the Nominating Committee fails to maintain the applicable qualifications, the member shall be deemed not to hold office and the seat formerly held by the member shall be deemed to be vacant for all purposes. The proposal also adopts new CBOE Constitution Section 4.9, which specifies that the Board may remove a Nominating Committee member in the event of the refusal, failure, neglect, or inability to discharge his or her duties, or for any cause affecting the best interests of the Exchange.

##### *Election and Voting Procedures*

The proposal adopts CBOE Constitution Section 3.8 to authorize the Board to set a "record date" to determine which members are entitled to receive notice and to vote in any Exchange election or vote. The record date will be the day preceding the date on which notice of the vote is given, if an alternate record date is not fixed by the Board. The proposal also amends CBOE Constitution Section 5.2 to provide that the Exchange may allow voting members to electronically submit ballots and proxies and to provide for a confidential electronic or online voting process in the future, if the Board determines to do so. The proposal also amends CBOE Constitution Section 10.1 to allow the Exchange to give notice to members and associated persons by messenger, courier service, facsimile or

electronic mail, as well as in person or by mail or telephone as is currently provided in Section 10.1 while deleting wireless, telegraph, and cable as available communication methods. In addition, the proposal amends Constitution Section 10.2 to allow for the waiver of notice by the same means as notice may be given.

##### *Provisions for Notice to CBOE Members*

The proposal adopts new CBOE Constitution Section 10.1(b) which limits the types of notices that may be given via e-mail to those notices provided in the *Exchange Bulletin* and *Regulatory Bulletin* and any other types of notices designated by the Board. CBOE Constitution Section 10.1(b) will specifically provide that the Exchange may provide the *Exchange Bulletin* and the *Regulatory Bulletin* (including the notices contained therein) by e-mail. In addition, Section 10.1(b) will allow the Exchange to permit members and associated persons to request delivery of the *Bulletins* (or such other notices as the Board may designate) by other means, in a form and manner prescribed by the Exchange.

##### *Securities Transaction Policy*

The proposal deletes CBOE Constitution Section 11.4, which generally prohibited officers and employees of the Exchange from trading any CBOE-listed option and required them to report to the Exchange every purchase or sale of any security underlying a CBOE-listed option. CBOE has represented that the securities transaction policy will now be included in the Exchange Employee Handbook, instead of in the Exchange's Constitution. The proposal also deletes from CBOE Rule 9.17 the requirement that a member organization must obtain authorization from the CBOE before executing securities transactions for officers or employees of any national securities exchange that is a participant of The Options Clearing Corporation.

CBOE has represented that it plans to liberalize the securities transaction policies to allow employees (with certain restrictions applicable to Regulatory Services Division employees) to trade CBOE-listed products and to require employees to report transactions in CBOE listed products to the Exchange. In addition, CBOE Rule 9.17 will continue to require member organizations to obtain authorization from the CBOE before executing securities transactions for CBOE officers and employees.

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

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

<sup>3</sup> See Securities Exchange Act Release No. 48950 (December 18, 2003), 68 FR 74991 ("Notice of Proposed Rule Change").

*Composition of the MTS Committee*

CBOE is amending Rule 8.82 to modify the composition of the MTS Committee. Under the proposed rule change, the nine elected members of the MTS Committee will include: three persons whose primary business is as a Market-Maker, three persons whose primary business is as a Market-Maker or as a Designated Primary Market Maker ("DPM") Designee, and three persons whose primary business is as a Floor Broker, at least two of whom represent public customer business in the course of their activities as a Floor Broker. The proposal removes a provision requiring that no more than two members of the MTS Committee be associated with a DPM. The Vice Chairman of the Exchange and the Chairman of the Market Performance Committee will continue to serve on the MTS Committee.

The amendments to CBOE Rule 8.82 also provide that one of the nine elected positions on the MTS Committee may instead be filled by a lessor whose primary business is not as a Market-Maker, DPM Designee, or Floor Broker, and whose primary residence is located within 80 miles of the Exchange's trading floor. In addition, the amendments to Rule 8.82 provide that the sole judge of whether a candidate satisfies the applicable qualifications for election to the MTS Committee in a designated category shall be the Nominating Committee, in the case of candidates nominated by the Nominating Committee, or the Executive Committee, in the case of candidates nominated by petition, and the decision of the respective committee shall be final. The proposal further amends CBOE Rule 8.82 to provide that: (i) no elected member of the MTS Committee may be affiliated with any other elected member of the MTS Committee; (ii) the term of office of elected MTS Committee members will commence at the time of the first regular Board meeting of the calendar year; (iii) the Board of Directors is the sole judge of whether or not an MTS Committee member no longer qualifies to serve on the Committee; (iv) the Board may remove MTS Committee members for cause; and (v) the Vice Chairman, with the approval of the Board, may fill vacancies on the MTS Committee until the first regular Board meeting of the calendar year following the next annual election. The MTS Committee monitors and implements the Exchange's DPM program.

*Terms of Office for Committee Members*

The proposed rule change also amends CBOE Rule 2.1 to provide that the term of office for committee members appointed pursuant to that Rule will continue until the first regular Board meeting of the next calendar year and until their successors are appointed or until death, resignation or removal. In addition, amended Rule 2.1 provides that any action taken by majority of the committee members voting, as opposed to present, at a meeting shall be the act of the committee.

*Other Business Activities of the President of the Exchange*

The Exchange also is amending CBOE Constitution Section 8.6 to allow the Board of Directors to exempt the President from the prohibition against engaging in any business other than as President of the Exchange, in the same manner that the Board may exempt the Chairman of the Board pursuant to Constitution Section 8.2. The Commission notes that the Pacific Exchange, Inc. ("PCX") has a similar provision in its Constitution.<sup>4</sup> In addition, the Commission notes that under CBOE Rule 8.1(d), the President cannot be affiliated with a CBOE member.

In addition to the changes described above, the Exchange is adopting changes to several provisions of its Constitution and rules that are intended to update those provisions to reflect current practice. Those changes are described in the Notice of Proposed Rule Change.

**III. Discussion**

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>5</sup> In particular, the Commission finds that the proposal is consistent with the requirements of Sections 6(b)(3)<sup>6</sup> and 6(b)(5)<sup>7</sup> of the Act. Section 6(b)(3) requires, among other things, that the CBOE's rules assure a fair representation of its members in the administration of its affairs. Section 6(b)(5) requires, among other things, that CBOE's rules be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and

practices, and, in general, protect investors and the public interest.

The Commission believes that the proposed rule change should clarify CBOE's Constitution with respect to the terms of office of its Directors and committee members, as well as the composition of its Nominating Committee and thereby should increase the efficiency of CBOE's governance. In addition, the Commission believes that the amendments to the composition of CBOE's MTS Committee are consistent with its obligation to ensure its members are fairly represented in the administration of its affairs, and should permit CBOE to include representatives of diversified broker-dealers on the Committee without permitting the Committee to become dominated by any one type of member constituency. Further, the Commission believes that the proposed rule change should update CBOE's election and voting procedures, as well as the methods by which CBOE may provide notice to its members.

**IV. Conclusion**

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change, as amended, (SR-CBOE-2003-55) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-49188; File No. SR-CHX-2003-17]

**Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Incorporated Relating to Automatic Quotations**

February 4, 2004.

On June 16, 2003, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act

<sup>4</sup> See PCX Constitution Section 2(a).

<sup>5</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(3).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).