

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

Jonathan G. Katz,  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43056; File No. SR-CBOE-99-15]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Membership Rules

July 19, 2000.

#### I. Introduction

On April 12, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to revise the CBOE's membership rules. The CBOE amended its proposal on July 15, 1999, November 3, 1999, and April 26, 2000.<sup>3</sup>

Notice of the proposed rule change and Amendment Nos. 1 and 2 were published for comment in the **Federal Register** on November 18, 1999.<sup>4</sup> The Commission received no comment letters regarding the proposal. This order approves the proposal, as amended. In addition, the Commission is publishing notice to solicit comments

on, and is simultaneously approving, on an accelerated basis, Amendment No. 3 to the proposal.

#### II. Description of the Proposal

As described below, the CBOE proposes to make extensive changes to revise and update its membership rules.

##### A. Definitions

The CBOE proposes to amend the definition of "lessor" in CBOE Rule 1.1(ff) to clarify that a member organization that is a lessor of an Exchange membership may transact business with the public, provided the organization is approved to do so pursuant to CBOE Rule 9.1, "Exchange Approval." Specifically, CBOE proposes to delete the second sentence of CBOE Rule 1.1(ff) because the CBOE believes that the sentence could be ready to imply that a lessor member organization is not permitted to transact business with the public.

The CBOE proposes to amend the definition of "nominee" in CBOE Rule 1.1(pp) to: (1) Clarify that under the CBOE's rules, as amended, not all nominees are required to have an authorized floor function,<sup>5</sup> and (2) eliminate a provision in the current definition indicating that all nominees shall be deemed to be Exchange members because CBOE Rule 3.8(b), as amended, states that a nominee of a member organization approved to act solely as a lessor shall be deemed an associated person of the organization and not an individual member.

##### B. CBOE Rules 3.1, 3.2, and 3.3

The CBOE proposes to revise CBOE Rule 3.1, "Public Securities Business," to clarify that the members referred to in subparagraphs (b)(1)(i) and (b)(1)(ii) are member organizations. CBOE Rule 3.1(b)(1)(i) refers to member organizations approved to transact business with the public in accordance with CBOE Rule 9.1, and CBOE Rule 3.1(b)(ii) refers to member organizations approved to clear Exchange transactions.

In addition, the CBOE proposes to delete CBOE Rule 3.1(b)(2), which requires compliance with Section 11(a) of the Act<sup>6</sup> for the following reasons: (1) CBOE Rule 4.2, "Adherence to Law," currently requires compliance with the Act; and (2) CBOE Rule 3.1(b) is intended to set forth permissible membership capacities for the purpose

of satisfying the requirement under Section 2.2 of Article II of the CBOE Constitution and CBOE Rule 3.1(a) that every member have as the principal purpose of its membership the conduct of a public securities business.

The CBOE also proposes to amend CBOE Rule 3.1 to refer separately to the membership capacity of a nominee and the membership capacity of an individual who has registered his or her membership for a member organization.

CBOE Rule 3.2, "Qualifications and Membership Statuses of Individual Members," as amended, clarifies certain requirements for individual members and lists individual membership statuses. Specifically, CBOE Rule 3.2(a) indicates that the current requirement that an individual member must be 21 years of age applies to every individual member and not solely to individual members who own memberships. CBOE Rule 3.2(b) and CBOE Rule 3.2, Interpretation and Policy .01, list all of the individual membership statuses under the Exchange's rules, including those that are approved by the CBOE's Membership Committee ("Membership Committee") and those that are approved by Exchange bodies other than the Membership Committee.<sup>7</sup> CBOE Rule 3.2(c) states that every individual member who is a lessee, a Chicago Board of Trade ("CBOT") exerciser, or an owner (who is not a lessor) must have an authorized floor function. CBOE Rule 3.2(c) also codifies the definition of an authorized floor function by indicating that an individual is deemed to have an authorized floor function if the member is approved by the Membership Committee to act as a market maker and/or floor broker.

<sup>7</sup> CBOE Rule 3.2(b) states that the individual membership statuses approved by the Membership Committee include: (i) owner; (ii) lessor; (iii) lessee; (iv) Chicago Board of Trade ("CBOT") exerciser; (v) sole proprietor; (vi) individual with a membership that has been registered for a member organization; (vii) nominee of a member organization; (viii) market maker; (ix) floor broker; (x) member eligible to trade securities pursuant to Chapter XXX of the CBOE's rules; and (xi) trust member. Proposed CBOE Rule 3.2(b) also notes that the individual permit statuses that are approved by the Membership Committee are IPC Permit exerciser and Options Trading Permit holder. Proposed Interpretation and Policy .01 lists the following individual membership statuses that are approved by CBOE bodies other than the Membership Committee: (i) Designated Primary Market Maker ("DPM") designee; (ii) FLEX appointed market maker for FLEX index options; (iii) FLEX qualified market maker for FLEX equity options; (iv) lead market maker in OEX or DJX options; and (v) supplemental market maker in OEX or DJX options. CBOE Rule 3.3, Interpretation and Policy .02 states that member organization membership statuses that are approved by CBOE bodies other than the Membership Committee include Designated Primary Market Makers.

<sup>22</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.

<sup>3</sup> See letter from Arthur B. Reinstein, Assistant General Counsel, CBOE, to Kenneth Rosen, Attorney, Division of Market Regulation ("Division"), Commission, dated July 14, 1999 ("Amendment No. 1"); letter from Arthur B. Reinstein, Assistant General Counsel, CBOE, to Yvonne Fraticelli, Division, Commission, dated November 3, 1999 ("Amendment No. 2"); and letter from Arthur B. Reinstein, Assistant General Counsel, CBOE, to Yvonne Fraticelli, Division, Commission, dated April 25, 2000 ("Amendment No. 3"). Amendment No. 1 made numerous technical changes to the proposed rule language and corresponding changes in the Purpose section of the CBOE's filing. Amendment No. 2 made minor technical corrections to the text of the proposed rule and made a conforming change by deleting Section 8(h) from the Exchange's Option Trading Lease Pool Procedures. Amendment No. 3 revised the requirements proposed in CBOE Rule 3.4 for foreign member organizations.

<sup>4</sup> See Securities Exchange Act Release No. 42111 (November 5, 1999), 64 FR 63065.

<sup>5</sup> Under proposed CBOE Rules 3.8(a)(iii) and 3.8(b)(iii), nominees of member organizations approved solely to transact business with the public and nominees of lessor member organizations are not required to have an authorized floor function.

<sup>6</sup> 15 U.S.C. 78k(a).

CBOE Rule 3.3, "Qualifications and Membership Statuses of Member Organizations," as amended, is similar in structure to CBOE Rule 3.2 and sets forth all of the membership statuses of member organizations under the Exchange's rules, including those that are approved by the Membership Committee and those that are approved by Exchange bodies other than the Membership Committee.<sup>8</sup> CBOE Rule 3.3(c) sets forth the longstanding Exchange policy that a member organization that is a clearing member or an order service firm must possess at least one membership for which the organization is not a lessor. CBOE Rule 3.3(d) clarifies that a member organization that desires to become a different type of business entity must apply for membership in the name of the new entity.

CBOE Rule 3.3, Interpretation and Policy .01, indicates that the members of a limited liability company will be deemed its principal shareholders, and its members with management responsibility and its managers will be deemed executive officers.

#### C. CBOE Rule 3.4

Currently, CBOE Rule 3.3 provides that an organization not organized under United States law may not become a member organization unless the organization is organized under other laws approved by the Exchange's Board of Directors. Due to the increasingly global nature of the securities markets, the Exchange has decided to amend its rules to permit foreign entities to become members of the Exchange, provided that the foreign entities satisfy the requirements set forth in new CBOE Rule 3.4, "Qualifications of Foreign Member Organizations," that are designed to eliminate potential hindrances to regulating foreign members. On April 26, 2000, the CBOE filed Amendment No. 3 to the proposal, which provides additional requirements for foreign

member organizations.<sup>9</sup> CBOE Rule 3.4, as amended, requires an organization not organized under the laws of the United States to:

- Be organized under the laws of a country with respect to which an information sharing agreement, memorandum of understanding, or treaty is in effect that provides the Commission with access to securities trading activity in that country;
- Disclose to the CBOE all persons associated with the organization and all tiers of ownership, until the ultimate beneficial owners of the organization are disclosed;
- Maintain in English at a location in the U.S. the books and records of the organization relating to the organization's business on the CBOE, including trading records, and any other books and records that a broker or dealer registered under Section 15 of the Act would be required to maintain;
- Maintain its financial records in accordance with U.S. accounting standards;
- Agree to permit inspections by the CBOE and by the Commission of the foreign operations of the organization related to its securities business;
- Waive applicable secrecy laws and be exempted from any applicable blocking statutes in its domiciliary jurisdiction;
- Provide the CBOE with an opinion of legal counsel of the domiciliary jurisdiction of the organization certifying that there are no applicable secrecy laws or blocking statutes or that the organization has effectively waived any applicable secrecy laws or is exempted from applicable blocking statutes in that jurisdiction;
- Require any customer of the organization that utilizes the organization to execute orders on the CBOE to have waived any applicable secrecy laws and be exempted from any applicable blocking statutes in the

domiciliary jurisdiction of the organization;

- Agree to submit to the jurisdiction of the federal courts of the U.S. and the courts of Illinois and to irrevocably waive any objection the organization may have based on venue or forum non conveniens;
- Own its CBOE membership;
- Register as a broker or dealer pursuant to Section 15 of the Act;<sup>10</sup> and
- Meet the other qualification requirements for membership under the CBOE's Constitution and rules.<sup>11</sup>

#### D. CBOE Rule 3.5

New CBOE Rule 3.5, "Denial of and Conditions to Membership and Association," a revised version of current CBOE Rule 3.4, clarifies the criteria for denial or conditioning membership or association with a member that are applicable only to broker-dealer applicants and revises one of the current grounds for denial or conditioning approval of a broker-dealer applicant. Specifically, CBOE Rule 3.5(a) states that the Membership Committee shall deny membership where an applicant has failed a required membership test. CBOE Rule 3.5(c)(i) provides that the Membership Committee may deny or condition the approval of a broker-dealer applicant if the applicant is an individual and has net worth (excluding personal assets) below \$25,000 or if the applicant is an organization and has net worth (excluding personal assets) below \$50,000. The CBOE believes that the proposed standard is appropriate in light of the financial resources typically not required to operate as an Exchange member.

Revised CBOE Rule 3.5(c)(i) also reflects the Exchange's intention to refrain from using an applicant's failure to pay debts that have been discharged in bankruptcy as a ground for denial or conditioning approval of an applicant. However, the CBOE notes that this provision is not intended to limit the CBOE's consideration of fraud or other violations of just and equitable principles of trade in connection with a bankruptcy proceeding in determining whether to deny or condition approval of the applicant.

CBOE Rule 3.5(e) states that any decision by the Membership Committee to deny or condition approval of an applicant must be consistent with both the provision of CBOE Rule 3.5 and the provisions of the Act.

<sup>8</sup> CBOE Rule 3.3(b) states that the member organization membership statuses approved by the Membership Committee for member organizations include: (i) owner; (ii) lessor; (iii); lessee; (iv) member organization for which an individual member has registered his or her membership; (v) member organization approved to transact business with the public; (vi) clearing member; and (vii) order service firm. CBOE Rule 3.3, Interpretation and Policy .02, indicates that the membership organization status approved by a body other than the Membership Committee includes is that of designated primary market maker. Proposed CBOE Rule 3.3(b) notes that member organization permit statuses approved by the Membership Committee are IPC permit exerciser and option trading permit holder. IPC permits were issued to persons who were member of the Bolsa Mexicana de Valores as of January 1, 1996. See CBOE Rule 3.26, "IPC Permits."

<sup>9</sup> Amendment No. 3 provides that: (1) a foreign member organization must be organized under the laws of a country which has an information sharing agreement, memorandum of understanding, or treaty in effect that provides the Commission with access to information concerning securities trading activity in that country; (2) clarifies that foreign member organizations must maintain in English at a location in the U.S. any books and records a U.S. broker-dealer is required to maintain at a location in the U.S.; (3) requires foreign member organizations to agree to permit inspections of their foreign securities operations by the Commission or the CBOE; (4) requires that foreign member organizations be exempted from applicable blocking statutes in their domiciliary jurisdiction; and (5) requires that customers of the organization that utilize the organization to execute orders on the CBOE to waive any applicable secrecy laws and be exempted from any applicable blocking statutes in the domiciliary jurisdiction of the organization. See Amendment No. 3, *supra* note 3.

<sup>10</sup> 15 U.S.C. 78o.

<sup>11</sup> See Amendment No. 3 *supra* note 3.

*E. CBOE Rule 3.6*

CBOE Rule 3.6, "Persons Associated with Member Organization," a revised version of current CBOE Rule 3.5, clarifies that the associated persons of a member organization that must be disclosed to the Exchange and approved by the Membership Committee include those associated persons that must be disclosed on the organization's Form BD as direct owners or executive officers, or, if the organization is a non-broker-dealer lessor member organization, those associated persons that would be required to be disclosed on Form BD in these capacities if the organization was broker-dealer. CBOE Rule 3.6 also states that no person may become associated with a member organization in the capacity of a direct owner or executive officer that is, or would be, required to be disclosed on Form BD unless and until the Membership Committee approves the association.

*F. CBOE Rule 3.7*

Many of the provision of CBOE Rule 3.7, "Certain Documents Required of Member, Applicants, and Associated Persons," restate with greater specificity the current requirements set forth in CBOE Rule 3.6 regarding documents that a member organization or applicant must file with the CBOE. For example, CBOE Rule 3.7(a) requires a member organization or applicant that is a corporation to file with the Membership Department a copy of the organization's articles or certificate of incorporation, by-laws, and amendments to those documents. CBOE Rule 3.7 establishes comparable requirements for member organizations or applicants that are partnerships and limited liability companies. In addition, CBOE Rule 3.7 requires member organizations and applicants to file with the Membership Department documents relating to the registration, governance, capital structure, or ownership of the organization that the CBOE requests and documents the CBOE, requests that are reasonable related to the member's businesses on the CBOE.

CBOE Rule 3.7 also requires members, member applicants, and their covered employees to comply with the provisions of Section 17(f) of the Act<sup>12</sup> and Exchange Act Rule 17f-2<sup>13</sup> regarding fingerprinting. In addition, CBOE 3.7 requires members and member applicants that are registered broker-dealers to comply with the requirement under Section 15 of the Act that broker-dealers complete and keep current Form BD. Members and member

applicants that are not registered broker-dealers must file and keep current a list of associated persons that have been or are applying to be approved by the Membership Committee. CBOE Rule 3.7, Interpretation and Policy .01, states that a limited liability company must file with the Membership Department a copy of the limited liability company's registration certificate, operating agreement and any amendments to those documents.

*G. CBOE Rule 3.8*

Currently, CBOE Rule 3.8, "Nominees," requires every member organization that owns leases a membership to authorize an individual nominee to represent the organization with respect to the membership in all matters relating to the CBOE. The CBOE proposes to amend CBOE Rule 3.8, which will be retitled as "Nominees and Members Who Register Their Memberships for Member Organizations," to restate and provide additional details regarding the requirements applicable nominees and members who register their memberships for member organizations.<sup>14</sup> CBOE Rule 3.8(a) requires each member organization that is not acting as a lessor and each member organization that a lessee of a membership to designate an individual nominee to represent the member organization with respect to CBOE matters, and to designate a different nominee for each membership the member organization owns a leases. The nominee, who must be approved for membership, must have an authorized floor function, except for the nominee for a member organization that is approved solely to transact business with the public. Each nominee will be deemed to be an individual member.

CBOE Rule 3.8(b) formalizes and clarifies the CBOE's rules regarding nominees of lessor member organizations. CBOE Rule 3.8(b) requires each lessor member organization to designate a single nominee to represent the organization in all matters relating to the Exchange with respect to all of the memberships for which the organization is a lessor. The nominee must satisfy all of the

qualification requirements for membership other than the requirements that are not applicable to lessors or that are applicable solely to members who will have an authorized floor function. The nominee of a lessor will be considered an associated person of the lessor member organization and not an individual member by virtue of being approved to act as a nominee in this capacity.

CBOE Rule 3.8(c) sets forth the current requirements that are applicable to an individual member who owns a membership or a CBOT exerciser that applies to register his or her membership for a member organizations. An individual who registers his or her membership for a member organization will represent the organization in all matters relating to the CBOE in the same manner that a nominee a member organization.

CBOE Rule 3.8(d) states that a member organization represented by a nominee or an individual who has registered his or her membership for the organization must agree to be responsible for all obligations arising out of that person's representation of the member organization in all matters relating to the CBOE and to guarantee payment of all monetary disciplinary sanctions assessed against that person with respect to activity that take place while the person is a nominee of the organization or has registered his or her membership for the organization.

CBOE Rule 3.8(d) also clarifies that a nominee shall not, solely by virtue of being a nominee of a member organization, have any person liability to the Exchange or to any other member for Exchange transactions and other securities transactions made by the nominee on behalf to the member organization. CBOE Rule 3.8, Interpretation and Policy .01, makes clear that nothing in CBOE Rule 3.8(d) is intended to define or limit: (1) Any obligations between a nominee of a member organization, or an individual who has registered his or her membership for a member organization, and the member organization itself; (2) any responsibility such a person may have for obligations of the member organization by virtue of a contractual obligation or ownership relationship to the organization beyond merely being a nominee or individual who has registered his or her membership for the organization; or (3) the ability of the Exchange to sanction or take other remedial action against such a person pursuant to other Exchange rules for rule violations or other activity for which remedial measures may be imposed.

<sup>14</sup> Under CBOE Rule 3.8(c), each individual member who owns a membership and each CBOT exerciser may apply to register his or her membership for a member organization. Upon approval of the application, an individual who has registered his or her membership for a member organization shall represent the organization in all matters relating to the CBOE in the same manner that a nominee represents a member organization. An individual who registers his or her membership for a member organization must have an authorized floor function.

<sup>12</sup> 15 U.S.C. 78q(f).

<sup>13</sup> 17 CFR 240.17f-2.

CBOE Rule 3.8(e) provides that each nominee of a member organization and each individual who has registered his or her membership for a member organization must be materially involved in the daily operation of the Exchange business activities of the member organization. According to the CBOE, this provision is intended to eliminate the potential ability under the Exchange's current rules for an organization to qualify for membership by associating with an individual who is designated as that organization's nominee or who registers his or her membership for the organization but who has little or no involvement with the organization's Exchange business activities. The Exchange proposes to prohibit such arrangements because they would dilute the value of the membership rights of other Exchange members and allow a person who is not materially involved in an organization's Exchange business activities to be designated to represent the member organization in all matters relating to the Exchange.

CBOE Rule 3.8(g) specifies rules and requirements applicable to inactive nominees of member organizations.

#### *H. CBOE Rule 3.9*

The CBOE proposes to amend CBOE Rule 3.9, "Application Procedures and Approval or Disapproval," to restate and revise the CBOE's membership application procedures. Proposed CBOE Rule 3.9(a) states that the following individuals or organizations must submit an application to the Membership Department: (1) Any individual or organization desiring to become a CBOE member; (2) any applicant or member desiring to act in one or more of the membership statuses set forth in CBOE, Rules 3.2(b) or 3.3(b); (3) any associated person that must be approved by the Membership Committee pursuant to CBOE Rule 3.6(b); and (4) any member desiring to change the clearing member that guarantees the member's CBOE transactions.

The CBOE proposes to add CBOE Rule 3.9(d), which will require each applicant to promptly update the applicant's application materials if any information provided in the materials becomes inaccurate or incomplete after the date when the application is submitted to the Membership Department and prior to approval of the application. This requirement is currently set forth in the application materials.

CBOE Rule 3.9(e) clarifies the current procedure allowing the Membership Committee to utilize a posting period for

any type of membership application.<sup>15</sup> CBOE Rule 3.9(f) states that the CBOE's Membership Department shall investigate each applicant applying to be a member organization, each associated person required to be approved by the Membership Committee pursuant to CBOE Rule 3.6(b), and each applicant applying to be an individual member, except for an individual member applicant who was an individual member within six months prior to the Membership Department's receipt of the applicant's application.<sup>16</sup> The CBOE states that CBOE Rule 3.9(f) clarifies that the Exchange typically does not investigate an individual member applicant who was an individual member within the prior six months because the person was recently an Exchange member.<sup>17</sup>

CBOE Rule 3.9(g) sets forth requirements applicable to persons required to have an authorized floor function, including the requirement that a person score 75% or better on the Floor Member Qualification Exam to pass the exam. The CBOE notes that these requirements were approved previously by the Commission but are not currently set forth in CBOE Rule 3.9.<sup>18</sup>

<sup>15</sup> CBOE Rule 3.9(b) currently states that the name of an applicant for membership shall be published in the Exchange Bulletin and posted on the Exchange Bulletin Board following the receipt of the application. CBOE Rule 3.9(e) states that for an application for membership, an application to change membership capacity statuses set forth in CBOE Rule 3.2(b) or 3.3(b), or an application to change clearing members, the name of the applicant and the application request shall be published in the Exchange Bulletin and posted on the Exchange Bulletin Board. The required posting period will be no less than 10 days, although the Membership Committee may shorten or waive the posting period. In addition, the required posting period for a member's application to change clearing members shall be waived if the clearing member(s) that will no longer be guaranteeing the member's CBOE transactions consents to a waiver.

<sup>16</sup> CBOE Rule 3.9(c) currently states every individual applicant and, in the case of applicant organizations, all persons associated with the organization, shall be investigated by the Membership Department before the Membership Committee approves an application.

<sup>17</sup> The CBOE generally conducts a less extensive review of the applications of individual member applicants who have been members within the previous six months, but will conduct a more extensive review if warranted. Telephone conversation between Arthur B. Reinstein, Assistant General Counsel, CBOE, and Yvonne Fraticelli, Special Counsel, Division, Commission, on June 9, 2000 ("June 9 Conversation").

<sup>18</sup> See Securities Exchange Act Release No. 32943 (September 22, 1993), 58 FR 50984 (September 29, 1993) (order approving File No. SR-CBOE-91-38) ("Membership Qualification Exam Order") (regarding procedural provisions related to the Exchange's requirement that individual membership applicants applying for an authorized floor function must pass the Exchange's Floor Member Qualification Exam).

CBOE Rule 3.9(h) allows the Membership Committee to approve an application only if the applicable posting period requirement has been satisfied, any investigation has been completed, and any applicable orientation and exam requirements have been satisfied. CBOE Rule 3.9(i) requires each applicant and each person associated with the applicant to submit any additional information requested by the CBOE and notes that such persons may be required to appear before the Membership Committee for an in-person interview or interviews.

CBOE Rule 3.9, Interpretation and Policy .01, requires a member to apply to the Membership Department to change the clearing member that guarantees the member's Exchange transactions. With its application, the member must include a financial statement setting forth the member's assets and liabilities. The Membership Department will provide a copy of the financial statement to the new clearing member designated in the application and will post notice to the membership that the application has been received unless the clearing member(s) that will no longer be guaranteeing the member's Exchange transactions waive this requirement. The amendment is intended to permit the clearing member(s) that will no longer be clearing the member's Exchange transactions, as well as other members, to notify the Membership Department of any outstanding liabilities that bear upon the member's qualification for membership and to provide the new clearing firm with information regarding the member's financial standing so that the clearing member will have the information available to manage the risk associated with the member's trading activities.

CBOE Rule 3.9, Interpretation and Policy .02 clarifies that a member organization seeking to change its name must submit an application to the Membership Department and that the Membership Committee may disapprove the name change application or membership application of an organization if the Membership Committee determines that the proposed name of the organization is confusingly similar to the name of an existing member organization.

#### *I. CBOE Rule 3.10*

The CBOE proposes to amend CBOE Rule 3.10, which will be retitled as "Effectiveness of Membership or Approved Person Status," to provide that each applicant for membership, for one of the membership statuses set forth in CBOE Rule 3.2(b) or 3.3(b), or for

approved associated person status under CBOE Rule 3.6(b), must become effective in the status within 90 days of the applicant's approval for the status, except that an applicant to become a lessor may become effective in that status within six months of the date of the applicant's approval for that status. The CBOE is adopting the six-month requirement for lessors because a lessor generally must purchase a membership to become an effective lessor and it is often difficult for a lessor to purchase a membership within 90 days.

#### *J. CBOE Rule 3.11*

The CBOE proposes to amend CBOE Rule 3.11, which will be retitled as "Notice of Effectiveness of Membership or Approved Associated Person Status," to reflect the Exchange's current procedures for notifying the CBOE membership of the effectiveness of any membership, membership status, or associated person status by publishing notice of the effectiveness in the Exchange Bulletin. The CBOE is deleting from CBOE Rule 3.11 the current requirements that such notices be mailed to all members and posted on the Exchange Bulletin Board because the notices are included in the Exchange Bulletin (which is forwarded to all members) and because the notices relate to statuses that have been approved, unlike notices of pending membership applications which are posted on the Exchange Bulletin Board so that members may submit comments to the Membership Department regarding an applicant's fitness for membership.

#### *K. CBOE Rule 3.12*

The CBOE proposes to amend CBOE Rule 3.12, which will be retitled "Membership Rights and Restrictions on Their Transfer," to indicate that certain rights may be granted to the grantee of an Authorization to Sell, as discussed more fully below, pursuant to new CBOE Rules 3.14(b) and 3.15(b). CBOE Rule 3.12(b)(ii) incorporates a provision currently contained in CBOE Rule 3.15(g) regarding restrictions on the transfer of membership rights.

#### *L. CBOE Rule 3.13*

The CBOE proposes to amend CBOE Rule 3.13, "Purchase of Membership," to clarify that: (1) Newly issued memberships may be purchased pursuant to procedures established by the CBOE; (2) only those approved to be an owner or a lessor may purchase a membership; (3) any bid to purchase a membership shall be canceled at such time that the bidder is no longer approved to be an owner or lessor; and (4) the purchaser of a membership must

pay for the membership within two business days of the acceptance of a bid for a newly issued membership or the matching of a bid and offer for an outstanding transferable membership.

#### *M. CBOE Rule 3.14*

The CBOE proposes several amendments to CBOE Rule 3.14, "Sale and Transfer of Membership." Specifically, the CBOE proposes to indicate in CBOE Rule 3.14(a) that the lowest offer for a CBOE membership will be published in the Exchange Bulletin as well as on the Exchange Bulletin Board. The CBOE proposes to amend CBOE Rule 3.14(b), "Sale by Exchange," to apply its provisions to members who are lessees as well as owner of transferable memberships.

The CBOE proposes to amend CBOE Rule 3.14(c) to require that an owner transferring a membership to an organization pursuant to CBOE Rule 3.14(c)(iii) must maintain an interest in the organization at least equal in value to the current market price of the membership, rather than an interest equal to the lower of the current market price or cost of the membership, as the rule currently provides. The CBOE notes that because the market price of a membership has increased significantly over the years, an ownership interest in an organization that equals the original cost of the membership may not longer reflect a material ownership interest in the organization. The CBOE also proposes to make a conforming change to CBOE Rule 3.14(c) to eliminate a deposit required under the current membership claims process, which the CBOE is revising as part of this proposed rule change.

The CBOE notes that Interpretation and Policy .01 to CBOE Rule 3.15, "Proceeds from the Sale of Membership," currently allows the Exchange to recognize and give effect to a valid instrument by which a member, in consideration of a loan or guarantee of a loan by another member for the purpose of purchasing a membership, has authorized the lending or guaranteeing member for the purpose of purchasing a membership, has authorized the lending or guaranteeing member to sell that membership. The CBOE proposes to adopt new CBOE Rule 3.14(d), "Authorizations to Sell," to replace this provision and expand upon it by permitting the owner of a transferable membership to voluntarily grant an Authorization to Sell the membership to any other member, including, but not limited to, another member who has provided or guaranteed a loan to the membership

owner for the purpose of purchasing a membership.

CBOE Rule 3.14(d) states that a membership owner will not be permitted to grant an Authorization to Sell a particular membership to more than one member. The grantee of an Authorization to Sell will have all of the authority granted under the Exchange's Constitution and rules relating to the sale of the membership that would otherwise be vested in the membership owner, although the grantee must notify the membership owner in writing at least three business days prior to exercising the grantee's right to sell the membership. An Authorization to Sell will be irrevocable and may only be canceled if the grantee of the Authorization to Sell consents to its cancellation. A membership owner that grants an Authorization to Sell will have no authority to direct the sale or transfer of the membership.

The Exchange will take direction solely from the grantee of an Authorization to Sell a membership with respect to matters relating to the sale of the membership. A membership owner and the grantee of an Authorization to Sell may enter into a written agreement, which must be filed with the Membership Department, setting forth the circumstances under which the grantee may exercise the grantee's authority to sell the membership, and any breaches of this written contract may be redressed through arbitration under Chapter XVIII of the Exchange's rules or through other means permitted by Chapter XVIII. The grantee of an Authorization to Sell that exercises its right to sell the membership may not be the purchaser of the membership unless the membership owner consents. The Membership Department will provide a member's clearing member(s) with a copy of any Authorization to Sell granted by the member, a cancellation of the Authorization to Sell, or a contract concerning the exercise of authority under the Authorization to Sell.

The grant of an Authorization to Sell will include the grant of a security interest in any proceeds from the sale of the membership that the grantee is authorized to receive under CBOE Rule 3.15(b), as discussed below. The Exchange will recognize a security interest of the grantee in any proceeds from the sale of a membership that the grantee is entitled to receive pursuant to CBOE Rule 3.15(b), but will not recognize any other lien or security interest in a membership or in the proceeds from the sale of a membership.

*N. CBOE Rule 3.15*

Current CBOE Rule 3.15 and certain provisions of CBOE rules 3.14, "Sale and Transfer of Membership," and Rule 3.16, "Special Provisions Regarding Memberships," provide a claims process whenever a membership is sold or transferred without a sale, at the beginning of a membership lease, and at the end of a membership lease. At these times, the Exchange, the Options Clearing Corporation ("OCC"), and CBOE members may submit claims against the owner of the membership that is being sold, transferred, or leased. At the end of a membership lease, the Exchange, the OCC, and CBOE members also may submit claims against the lessee of the membership.

In the case of a sale, claims that the Board of Directors determines are valid are satisfied from the proceeds of the sale. In the case of a transfer or the beginning or end of a lease, the owner of the membership that is the subject of the transfer or lease must post cash with the Exchange in an amount equal to the last membership sale or obtain a letter of guarantee from a clearing member to satisfy the payment of any valid claims.<sup>19</sup>

The Exchange proposes to modify the membership claims process so that the only permissible claimant under the process will be the grantee of an Authorization to Sell. Under the revised procedures, the claims process will occur only upon the sale of a membership and lessors will no longer be liable under the claims process for the debts and liabilities of their lessees. The Exchange believes that it is not equitable for a lessor to be liable under the membership claims process for the debts and liabilities of a lessee, particularly when, as is usually the case, the lessor had no involvement in incurring a lessee's debts and liabilities and no means to monitor the lessee's activities. The Exchange also believes that the proposed modifications to the membership claims process, when coupled with the ability to grant an Authorization to Sell a membership, will produce greater demand for ownership of Exchange memberships. In addition, the CBOE believes that the proposed modifications will eliminate the significant administrative burden on the Exchange, clearing members, and other members that is a byproduct of the current membership claims process. At the same time, the CBOE notes that members will continue to have the right to pursue claims against other members through the arbitration process.

Accordingly, the CBOE proposes to amend CBOE Rule 3.15 to establish a modified claims process following the sale of a membership. Specifically, CBOE Rule 3.15 provides that, following the sale of a membership for which an Authorization to Sell has been granted, the grantee will have two business days from the date of the sale to notify the Membership Department of any claims the grantee has against the member whose membership was sold. The claims must be related to the CBOE business activities of the member whose membership was sold.<sup>20</sup> The member whose membership was sold will have five business days from the date of the sale to either acknowledge or contest the claims. The Exchange will remit to the grantee the portion of the sale proceeds applicable to the claims acknowledged by the member whose membership was sold, escrow the portion of the sale proceeds applicable to any claims contested by the member whose membership was sold, and remit to the member whose membership was sold any remaining portion of the sale proceeds.

Any portion of the sale proceeds applicable to contested claims that have been escrowed will remain in escrow until the grantee and the member whose membership was sold resolve the claims through arbitration under Chapter XVIII of the Rules or through other means permitted by that Chapter. However, the Exchange may release to the member whose membership was sold sale proceeds that have been escrowed due to contested claims if the Exchange determines that the grantee of the Authorization to Sell is not proceeding in good faith to resolve the contested claims. Following the resolution of any contested claims for which sale proceeds have been escrowed, the Exchange will remit the escrowed proceeds to the grantee and the member whose membership was sold in accordance with the resolution of the claims.

*O. CBOE Rule 3.16*

The CBOE proposes to amend CBOE Rule 3.16, which will be retitled "Special Provisions Regarding Chicago Board of Trade Exerciser Memberships," to clarify that a nontransferable CBOT

exerciser membership acquired pursuant to Paragraph (b) of Article Fifth of the Exchange's Certificate of Incorporation will terminate upon receipt by the Membership Department of written notice from the CBOT exerciser member that he or she is surrendering the membership or at such time when the CBOT exerciser member is no longer entitled to membership on the Exchange in accordance with Paragraph (b) of Article Fifth. In addition, the CBOE proposes to delete the provisions regarding leased memberships currently contained in CBOE Rule 3.16(b) and restate them in an amended form in new CBOE Rule 3.17, "Leased Memberships."<sup>21</sup>

*P. CBOE Rule 3.17*

CBOE Rule 3.17 restates many of the provisions regarding leased memberships that currently are contained in CBOE Rule 3.16(b) and also incorporates several substantive changes to those provisions. CBOE Rule 3.17(a) states that the owner of a transferable membership in good standing may lease the membership provided that the lessee is approved for membership, the lease is made pursuant to a written lease agreement, and the lease is preapproved by the CBOE. CBOE Rule 3.17(a) also clarifies that the Exchange will bear no liability to a lessor or lessee in connection with the Exchange's review and approval of a lease agreement.

In connection with the modification of the current membership claims process and the elimination of a lessor's liability under the process for claims against a lessee, the Exchange proposes to include a provision in CBOE rule 3.17(b) stating that a lessor of a membership will have no liability for claims against a lessee of the membership solely by virtue of being a lessor of the membership. CBOE Rule 3.17(b) also clarifies that this provision is not intended to limit or define any responsibility a lessor may have for claims against a lessee by virtue of a contractual obligation or ownership relationship between the lessor and lessee beyond the lease of a membership. Similarly, the Exchange proposes to eliminate the current provision of CBOE Rule 3.16(b) stating that any division of rights and responsibilities between the lessor and lessee will not affect the lessor's obligation to pay all amounts due to the CBOE.

<sup>20</sup> For purposes of CBOE Rule 3.15, claims related to CBOE business activities include claims associated with CBOE transactions, securities or futures transactions other than on the CBOE that are related to CBOE transactions or positions resulting from CBOE transactions, loans or guarantees of loans for the purpose of purchasing a CBOE membership, and services provided in connection with the foregoing. The CBOE will determine whether a claim is related to Exchange business activities. See CBOE Rule 3.15(b)(ii).

<sup>21</sup> Current CBOE Rule 3.17, "Death, Retirement, Withdrawal and Resignation," will be revised and will appear in new CBOE Rule 3.19, "Termination from Membership."

<sup>19</sup> See CBOE Rule 3.16(b)(ii).

CBOE Rule 3.17(c) states that the Exchange may specify that particular provisions be included in membership lease agreements in addition to those specifically designated in CBOE rule 3.17(c).

CBOE Rule 3.17(d) requires a lessee to promptly file the lease agreement and any amendments to the lease agreement with the Membership Department and to promptly notify the Membership Department of any termination of the lease before the termination becomes effective. The CBOE proposes to place these obligations on lessees because lessees are present at the Exchange to conduct their activities.

CBOE Rule 3.17(e) provides that if a lessor sells or transfers a membership while it is being leased, the purchaser or transferee of the membership must lease the membership to the lessee pursuant to the terms of the lessee's existing lease agreement for a period of 20 business days following the date the membership is transferred to the purchaser or transferee. The purchaser or transferee may also satisfy this requirement by making arrangements with another membership owner to permit the lessee to lease a membership from that owner for the required time period pursuant to the terms of the lessee's existing lease agreement.

CBOE Rule 3.17(e) states that a lessor will violate CBOE Rule 3.17(e) if the lessor circumvents the requirements of proposed CBOE Rule 3.17(e) by improperly terminating a membership lease prior to the sale or transfer of the membership for the purpose of avoiding the applicability of proposed CBOE Rule 3.17(e). If the Exchange determines that a lessor has improperly terminated a membership lease to avoid the applicability of CBOE Rule 3.17(e), the Exchange may impose the requirements of CBOE Rule 3.17(e) upon the purchaser or transferee of the membership and/or take disciplinary action against the lessor.

CBOE Rule 3.17(f) states that a lessor that sells or transfers a membership while it is being leased must remit to the purchaser or transferee any amounts paid to the lessor under the lease agreement for any portion of the lease period, up to 20 business days, during which the lessor will no longer be leasing the membership. The lessor must remit these amounts to the purchaser or transferee no later than the date the membership is transferred. By the transfer date the lessor also must remit to the lessee any remaining amounts the lessee has paid to the lessor under the lease agreement for any portion of the lease period beyond the foregoing 20 business day period.

#### *Q. CBOE Rule 3.18*

The CBOE proposes to adopt new CBOE Rule 3.18, "Members and Associated Persons Who Are or Become Subject to a Statutory Disqualification," to modify its procedures for determining whether, or under what conditions, to permit the continued membership or association of a member or associated person who is or becomes subject to a statutory disqualification.<sup>22</sup>

Currently, CBOE Rule 3.4 authorizes the Membership Committee to determine whether to permit a member or associated person who is or becomes subject to a statutory disqualification to continue in membership or association with a member or to condition such continuance in membership or association. Under the CBOE's current rules, the member or associated person has the right to appeal the Membership Committee's decision to the Exchange's Appeals Committee and to appeal the Appeals Committee's decision to the Exchange's Board of Directors. These appeal rights must be exhausted before the membership Committee's decision can take effect. Therefore, the CBOE notes that it is possible for a member or associated person to become subject to a statutory disqualification, such as a serious felony conviction, and continue to act as a member or associated person for an extended period of time while the appeal proceedings are pending.

Accordingly, the Exchange proposes to adopt more expedited procedures. The CBOE believes that its revised procedures will provide due process to the member or associated person that is or has become subject to a statutory disqualification without a right of appeal to the Appeals Committee and then to the Board of Directors.

Under the modified procedures in CBOE Rule 3.18, a member or associated person who is or becomes subject to a statutory disqualification and wants to continue in Exchange membership or association with a member must submit an application to the Membership Department within 10 days of becoming subject to the statutory disqualification.<sup>23</sup> Following receipt of the application, or in the event the Exchange becomes aware that a member

or associated person is subject to statutory disqualification and has failed to submit an application to continue in membership or association within the required time period, the Chairperson of the Membership Committee will appoint a panel composed of the Membership Committee Chairperson and two other members of the Membership Committee to conduct a hearing concerning the matter. The hearing panel will hold a hearing 14 or more days following the receipt of the application or the initiation of the proceeding, and both the subject of the proceeding and Exchange staff will be afforded an opportunity to present relevant information, arguments, and witnesses during the hearing. Any person who is the subject of a proceeding under CBOE Rule 3.18 is entitled to be accompanied, represented, and advised by counsel at all stages of the proceeding.

Following the hearing, the hearing panel will present its recommended decision in writing to the Membership Committee, which may ratify or amend the decision. The Membership Committee will render its decision in writing and promptly provide its decision to the subject of the hearing and the Executive Committee, which may determine within seven days after the issuance of the Membership Committee's decision to order a review of the decision. If the Executive Committee does not order review of the decision, the Membership Committee's decision will become the final decision of the Exchange.

If the Executive Committee orders review of the Membership Committee's decision, the Executive Committee or a panel comprised of at least three members of the Executive Committee will conduct the review. The Executive Committee must ratify the panel's decision. The Executive Committee's decision, which must be in writing, will be the final decision of the Exchange.

The CBOE notes that the CBOE's Executive Committee is composed of the Exchange's Chairman, Vice Chairman, President, and at least four other Exchange directors. According to the CBOE, the Executive Committee generally is authorized under Section 7.2 of Article VII of the Exchange's Constitution to exercise all the powers and authority of the CBOE's Board of Directors in the management of the business and affairs of the Exchange. The Exchange proposes to utilize the Executive Committee as the review body under CBOE Rule 3.18, instead of the Board of Directors, because the Executive Committee is generally able to

<sup>22</sup> Current CBOE Rule 3.18, "Dissolution and Liquidation of Member Organizations," will be amended and renumbered as CBOE Rule 3.20.

<sup>23</sup> In addition, CBOE Rule 3.18, Interpretation and Policy .02, requires a member to provide immediate written notice to the Membership Department of the name of any associated person who is or becomes subject to a statutory disqualification, the person's capacity with the member, and the nature of the statutory disqualification.



convene more quickly than the Board of Directors because of its smaller size.

If the Exchange decided to permit a member or associated person who is subject to a statutory disqualification to remain in membership or association, the Exchange would also submit a notice to the Commission to the extent required by Rule 19h-1 under the Act.<sup>24</sup>

CBOE rule 3.18, Interpretation and Policy .01, allows the CBOE to waive the provisions of proposed CBOE Rule 3.18 when a proceeding is pending before another self-regulatory organization to determine whether to permit an associated person or a member to continue in association or membership. In addition, CBOE Rule 3.18, Interpretation and Policy .01 states that if the CBOE waives the provisions of CBOE Rule 3.18, the Department of Financial and Sales Practice Compliance will determine whether the CBOE will concur in any Exchange Act Rule 19h-1 filing made by another self-regulatory organization.

#### R. CBOE Rule 3.19

CBOE Rule 3.19, "Termination from Membership," which replaces current CBOE Rule 3.17, clarifies that the membership status of a member terminates automatically if the member does not possess a membership through ownership, lease, or registration of a membership to the member. In addition, CBOE Rule 3.19 states that the membership of a member organization terminates automatically if the member organization has no nominee or person who has registered his or her membership for the member organization.

#### S. CBOE Rule 3.20

CBOE Rule 3.20, "Dissolution and Liquidation of Member Organizations," restates the provisions currently set forth in current CBOE Rule 3.18 and amends those provisions by requiring a member organization to provide written notice of the adoption of a plan of liquidation or dissolution, and any actual liquidation or dissolution, to both the Department of Financial and Sales Practice Compliance and the Membership Department.

#### T. CBOE Rule 3.21

CBOE Rule 3.21, "Obligations of Terminating Members," restates requirements applicable to terminating members which are currently set forth in current CBOE Rule 3.19. In addition, in connection with the elimination of the Exchange's ability to submit claims against the proceeds of a membership

sale, the Exchange proposes to delete the provision of current CBOE Rule 3.19 which permits the Exchange to withhold the distribution of the proceeds of the sale of a membership if the seller is not current in the payment of Exchange fees or the submission of various filing.

#### U. CBOE Rule 1.1(hh), 3.20, 3.21, 3.22, 3.22A, and 6.20

The CBOE proposes to delete current CBOE Rules 3.20, 3.21, 3.22, 3.22A, and 6.20, Interpretation and Policy .03, which relate to government securities options permits, because all the government securities options permits have expired. Similarly, the CBOE proposes to delete CBOE Rule 1.1(hh), which defines a government securities options permit holder.

#### V. CBOE Rule 3.25

The CBOE proposes to amend CBOE Rule 3.25, "Transfer of Individual Membership in Trust," to clarify that: (1) A member who owns a membership may transfer the membership only into a living trust; (2) a member who wishes to transfer a membership into trust must submit an application to the Membership Department, which must be approved by the Exchange; (3) a member who has transferred a membership in trust ("Trust Member") must submit to the Membership Department any amendments to the trust agreement and notify the Membership Department of any changes in the information set forth in the application to transfer the membership in trust, any changes in the successor trustee, any release of the membership out of trust, and any termination of the trust; and (4) the Exchange will deem a membership held in trust to have reverted to the Trust Member to be held directly and not in trust if the membership is released from the trust, the trust terminates, or the trust agreement is amended so that it no longer complies with the requirements of CBOE Rule 3.25. CBOE Rule 3.25(c) also notes that a member may grant an Authorization to Sell with respect to a membership held in trust.

#### W. CBOE Rule 3.27

In connection with the modification of the current claims process that applies to memberships, the Exchange proposes to amend CBOE Rule 3.27 to make the same modifications to the corollary claims process that is applicable to Options Trading Permits. The CBOE proposes to make a corresponding conforming change to Regulatory Bulletin 00-37, "Option Trading Permit lease Pool Procedures,"

by deleting paragraph 8.h, which states that a lease of an Options Trading Permit will not become effective until a letter of guarantee equal to the last sale price of an Options Trading Permit has been deposited with the Membership Department.<sup>25</sup>

#### X. CBOE Rule 3.28

The CBOE proposes to adopt CBOE Rule 3.28, "Extension of Time Limits," to clarify that the Membership Committee may extend any time limit imposed on an applicant, member, or other person under Chapter III of the Exchange's rules if the Membership Committee determines that such an extension is warranted due to extenuating circumstances. This proposed provision is similar to CBOE Rule 17.13 "Extension of Time Limits," which authorizes the Exchange to extend time limits provided for under Chapter XVII of the Exchange's rules.

#### Y. CBOE Rule 3.29

The CBOE states that because there are many types of membership-related applications and approvals provided for under Chapter III, the Membership Committee may wish to delegate to the Membership Department the authority to act on certain routine types of applications and approvals to allow the Membership Committee to focus its attention on more significant types of membership-related applications and approvals. Accordingly, new CBOE Rule 3.29, "Delegation of Authority," clarifies that all of the authority granted to the Exchange under Chapter III of the Exchange's rules may be exercised by the Membership Committee and/or the Membership Department and that the Membership Committee may delegate to the Membership Department any of the authority that is granted to the Membership Committee under the Exchange's rules.

#### Z. CBOE Rule 6.76A

The CBOE proposes to adopt CBOE Rule 6.76A, "Automated Billing Process for Market Maker Brokerage Bills," to streamline the processing and payment of bills for brokerage services that floor brokers and order service firms provide to market makers. The CBOE also proposes to implement the automated billing process because floor brokers and order service firms will no longer have the ability to submit claims for outstanding brokerage bills as part of the membership claims process. The automated billing process operates as follows:

<sup>24</sup> 17 CFR 240.19h-1.

<sup>25</sup> See Amendment No. 2, *supra* note 3.



- Each floor broker and order service firm must submit a written bill by the sixth day of the month to each market maker customer of the floor broker or order service firm for brokerage fees the market maker incurred during the prior month.

- A market maker will have until the tenth day of the month to inform the floor broker or order service firm if the market maker disputes any portion of the bill.

- A floor broker or order service firm that has submitted a bill to a market maker by the sixth day of the month will notify the Exchange's Accounting Department by the twelfth day of the month of the amount to bill each market maker customer of the floor broker or order service firm for brokerage fees incurred during the prior month.

- The CBOE will take direction solely from the floor broker or order service firm with respect to the amount to bill a market maker pursuant to the automated billing process. If the market maker disputes the amount a floor broker or order service firm has instructed the CBOE to bill, the market maker may pursue a claim against the floor broker or order service firm in arbitration under Chapter XVIII of the CBOE's rules or through other means provided by Chapter XVIII. In addition, if a floor broker or order service firm improperly instructs the Exchange to bill a market maker for brokerage fees which the floor broker or order service firm is not entitled to receive, the Exchange may discipline the floor broker or order service firm pursuant to Chapter XVII of the Exchange's rules for violating CBOE Rule 4.6, "False Statements," by submitting false statements to the Exchange.

- By the twenty-first day of the month, the Accounting Department will provide a monthly market maker floor brokerage billing list to each clearing member that clears market maker transactions. The list will set forth the amounts floor brokers and order service firms have instructed the Accounting Department to bill each market maker that clears through that clearing member for brokerage fees incurred by the market maker during the prior month.

- A clearing member may instruct the Accounting Department not to draft the clearing member pursuant to the automated billing process for that portion of the brokerage fees billed to a market maker that would cause the market maker to have a negative balance in the market maker's account at the clearing member.

- On the twenty-fifth day of the month, the Exchange will draft from each clearing member's account at the

OCC the total amount billed pursuant to the automated billing process to market makers that clear through that clearing member. The Exchange will then promptly distribute the amounts drafted to the applicable floor brokers and order service firms. Each clearing member will be authorized to deduct from a market maker's account at the clearing member the amounts the CBOE has drafted from the clearing member's account at the OCC for brokerage fees billed to the market maker.

- If a clearing member instructs the Accounting Department not to draft a portion of the brokerage fees billed to a market maker, the Exchange will distribute brokerage fees which were drafted from the clearing member for that market maker on a pro rata basis to the floor brokers and order service firms that submitted instructions to bill the market maker.

- If a clearing member instructs the Accounting Department not to draft a portion of the brokerage fees billed to a market maker and the market maker later has a positive balance in the market maker's account at the clearing member, the clearing member must deduct from the account the amount of the brokerage fees that the clearing member previously instructed the Accounting Department not to draft and distribute the funds to the floor brokers and order service firms who previously did not receive full payment.

- If a floor broker or order service firm fails to satisfy the submission deadlines provided for under the automated billing process, the floor broker or order service firm may not bill the market maker for brokerage fees pursuant to the automated billing process. However, the floor broker or order service firm may bill the market maker for brokerage fees in the regular, non-automated fashion.

To contribute to defraying the Exchange's cost of administering the automated billing process, the Exchange proposes to assess, in a form and manner prescribed by the Exchange: (1) A \$0.50 fee to each floor broker and order service firm for each bill of \$5.00 or more from the floor broker or order service firm that is assessed to a market maker under this billing process; and (2) a \$0.50 fee to each market maker for each bill of \$5.00 or more from a floor broker or order service firm that is assessed to the market maker under this billing process.

#### *AA. CBOE Rules 6.72, 6.78 and 8.5*

The CBOE proposes to amend CBOE Rules 6.72, "Letters of Authorization," 6.78, "Letters of Guarantee Required of Order Service Firms," and 8.5, "Letter

of Guarantee," to provide that the CBOE will post notice of a clearing member's revocation of its guarantee only at the clearing member's request. The Exchange does not believe that it is necessary to require the posting of all revocations because most are routine and arise because a member is terminating from membership or is changing the clearing member that guarantees the member's Exchange transactions.

In addition, revised CBOE Rule 6.72 states that: (1) A revocation will not relieve a clearing member of responsibility for transactions guaranteed prior to the effective date of the revocation; and (2) a floor broker may only have one letter of authorization guarantee from a clearing member in effect at a time.

The CBOE proposes to amend CBOE Rule 8.5 to clarify that a market maker that clears transactions through more than one clearing member must have a letter of guarantee issued by each clearing member to cover the CBOE transactions executed by the market maker through the clearing member. The CBOE also proposes to add Interpretation and Policy .04 to CBOE Rule 8.5, which states that the CBOE will notify each clearing corporation that has approved a letter of guarantee for a market maker of the issuance and revocation, if applicable, of all other letters of guarantee issued to that market maker with regard to transactions subject to the rules of any other clearing corporation.

#### *BB. CBOE Rule 8.9*

The CBOE proposes to add Interpretation and Policy .08 to CBOE Rule 8.9, "Securities Accounts and Orders of Market Makers." Interpretation and Policy .08 clarifies that each participant in a joint account will be jointly and severally liable for any losses incurred by the joint account. However, Interpretation and Policy .08 also states that for a joint account participant that is the nominee of a member organization, or an individual who has registered his or her membership for a member organization, and who is not acting as an independent market maker pursuant to CBOE Rule 3.8(f), the member organization and not the participant will be liable for losses incurred by the joint account. The clarification is intended to make applicable to joint accounts the general provisions in CBOE Rule 3.8(d), which clarify that neither a nominee nor an individual who has registered his or her membership for a member organization shall, solely by virtue of being a nominee of a member organization or

having registered his or her membership for a member organization, have any personal liability to the Exchange or to any other member for Exchange transactions and other securities transactions made by the nominee or individual on behalf of the member organization.

*CC. CBOE Rules 9.3, 10.11, and 15.1*

The CBOE proposes to amend CBOE Rule 9.3, "Registration and Termination of Representatives," to clarify the associated persons who are required to complete Form U-4 (*i.e.*, persons who perform duties for member organizations approved to transact business with the public which are customarily performed by sales representatives, solicitors, customers' men, or branch office managers). Notwithstanding the foregoing, the Exchange may continue to require other applicants to complete Form U-4 during the application process solely as an information gathering tool. In addition, the CBOE proposes to add new Interpretation and Policy .01 to CBOE Rule 9.3, which will clarify that the application form referred to in CBOE Rule 9.3(a) is the Form U-4, and that any person required to file Form U-4 must promptly file any required amendments to Form U-4.

The CBOE proposes to amend CBOE Rule 10.11, "Contracts of Suspended Parties," to refer to the claims resolution procedures in CBOE Rule 3.15.

The CBOE proposes to amend Interpretation and Policy .01 to CBOE Rule 15.1, "Maintenance, Retention and Furnishing of Books, records and Other Information," to revise references to specific CBOE rules regarding the maintenance of books and records and the furnishing of information to the CBOE. The new references reflect the proposed changes to the CBOE's membership rules.

*DD. CBOE Rule 18.2*

To ensure that clearing members receive notice of proceedings involving disputed trades, the CBOE proposes to add Interpretation and Policy .01 to CBOE Rule 18.2, "Procedures in Member Controversies," which will require each party to an arbitration concerning the alleged failure to honor a trade to promptly provide copies of all documents filed or received in the arbitration by that party to the clearing member(s) that guaranteed that party's Exchange transactions when the alleged trade took place.

*EE. CBOE Rules 6.72, 24A.15, 26.11, 26.13, and 30.74*

The CBOE proposes to make conforming changes to CBOE Rules 6.72, 24A.15, "Letter of Guarantee or Authorization," 26.11, "Market Makers," 26.13, "Floor Broker Financial Requirements," and 30.74, "Clearing of System Transactions," that delete references to the current membership claims process.

*FF. Membership Fee Circular*

The Exchange is proposing to amend its Membership Fee Circular ("Circular") to delete two introductory paragraphs regarding certain rule requirements related to membership that will be set forth more fully in the membership rules themselves. The revised Circular will contain only information regarding membership fees.

The Exchange proposes to amend the description in the Membership Fee Circular of the fee payable by an applicant who is subject to a statutory disqualification to reflect that the rule provisions that govern such applicants are set forth in new CBOE Rule 3.18. The CBOE also proposes to clarify the fees relating to partnership agreement amendments by indicating that a fee is payable each time a member organization's bylaws, partnership agreement, or operating agreement is amended. In addition, the revised Circular will state that a CBOT exerciser, as well as other members, must pay the fingerprint processing fee.

*GG. Special Members*

The CBOE proposes to delete references to special members from CBOE Rules 3.12, 3.14, 3.16, 6.5, and 9.1 because all special memberships on the CBOE have expired.<sup>26</sup>

*HH. Effectiveness of the Proposed Rule Change*

The CBOE proposes to provide that the rule change will become effective 30 days from the date of its approval by the Commission. The CBOE believes that the 30-day period will provide the Exchange with an opportunity to notify the Exchange's membership of the effectiveness of the rule change and provide members who wish to grant or receive Authorization to Sell with an opportunity to do so before the amended rule provisions take effect.

### III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the Act

and the rules and regulations under the Act applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act.<sup>27</sup> Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. In addition, as described more fully below, the Commission finds that various provisions of the proposal are consistent with the requirements of Sections 6(b)(1), 6(b)(4), and 6(c)(3) of the Act, and with Rules 15c3-1 and 19h-1 under the Act.<sup>28</sup>

#### A. Definitions

The Commission finds that the proposed amendments to CBOE Rule 1.1 will update and clarify CBOE Rule 1.1 and ensure consistency with other CBOE rules. Specifically, the Commission believes that the revised definition of "lessor" make clear that a lessor may conduct a public securities business, provided that the organization is approved to do so pursuant to CBOE Rule 9.1. Similarly, the revised definition of "nominee" makes clear that all nominees need not have an authorized floor function, making the definition of "nominee" consistent with new CBOE Rules 3.8(a)(iii) and 3.8(b)(iii). In addition, the revised definition of "nominee" eliminates the provision in the current definition stating that a nominee will be deemed to be an Exchange member, thereby making the definition of "nominee" consistent with new CBOE Rule 3.8(b)(v), which states that the nominee of a member organization acting as a lessor will be deemed to be an associated person of the organization and not an individual member.

#### B. CBOE Rules 3.1, 3.2, and 3.3

The Commission finds that the proposed changes to CBOE Rules 3.1, 3.2, and 3.3 will clarify the rules and help to ensure consistency in the CBOE's rules. Specifically, the Commission believes that amending CBOE Rules 3.1(b)(1)(i) and (b)(1)(ii) to refer to member organizations, rather

<sup>27</sup> 15 U.S.C. 78f(b)(5).

<sup>28</sup> 15 U.S.C. 78f(b)(1), 78f(b)(4), 78f(c)(3), 17 CFR 240.15c3-1, and 17 CFR 240.19h-1. In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>26</sup> See CBOE Constitution, Article II, Section 2.1(d).

than members, will add clarity and consistency to the CBOE's rules because only member organizations may perform the functions referred to in subparagraphs (b)(1)(i) and (b)(1)(ii).

The Commission believes that amendments to CBOE Rule 3.1(a)(3) and (4) that refer separately to the membership capacity of a nominee and the membership capacity of an individual who has registered his or her membership for a member organization make clear that both a nominee and an individual who has registered his or her membership for a member organization are CBOE members.

The Commission believes that the deletion of current CBOE Rule 3.1(b)(2), which requires compliance with Section 11(a) of the Act, will clarify CBOE Rule 3.1 by limiting its scope to the principal purpose of an Exchange membership, *i.e.*, the conduct of a public securities business, and the membership capacities that satisfy that requirement. At the same time, the Commission notes that the CBOE's rules and policies will continue to require compliance with Section 11(a) of the Act. In this regard, the Commission notes that CBOE Rule 4.2 prohibits CBOE members from engaging in conduct that violates the Act and other rules insofar as they relate to the reporting or clearance of any CBOE transactions,<sup>29</sup> and CBOE Rule 4.1, "Just and Equitable Principles of Trade," prohibits members and associated persons from engaging in acts or practices inconsistent with just and equitable principles of trade. In addition, CBOE Regulatory Circular RG94-11 explains the requirements of Section 11(a) of the Act to CBOE members.

The Commission believes that the proposal to amend CBOE Rule 3.2 to clarify that every individual member must be 21 years of age will help to ensure that only qualified persons will be eligible to become CBOE members. The Commission believes that the proposal to list in CBOE Rule 3.2 all of the individual membership statuses will help to inform individual members of the available individual membership statuses provided under the CBOE's rules. In addition, the Commission believes that CBOE Rule 3.2(c), which specifies the individual members who must have an authorized floor function,

will help to notify individual members of the requirement applicable to them. The Commission believes that it is reasonable for the CBOE to further clarify this requirement by indicating that an individual member will be deemed to have an authorized floor function if the member is approved to act as a market maker and/or floor broker.

The Commission believes that the proposal to amend CBOE Rule 3.3 to set forth all of the member organization membership statuses will help to inform member organizations of the available member organization membership statuses provided under the CBOE's rules. The Commission also believes that the CBOE's proposal to codify in CBOE Rule 3.3(c) its long-standing policy that a clearing member or order service firm must possess at least one membership for which the organization is not a lessor will help to ensure that clearing members and order service firms are aware of the requirement. In addition, the Commission believes that the proposal to provide in CBOE Rule 3.3(d) that a member that wishes to become a different type of business entity must reapply for membership in the name of the new entity will help the CBOE to ensure that the new entity continues to satisfy the CBOE's membership requirements.

The Commission believes that the CBOE's proposal to amend CBOE Rule 3.3, Interpretation and Policy .01, to state that the limited liability company's members will be deemed principal shareholders and its members with management responsibility and its managers will be deemed executive officers will clarify the treatment of limited liability companies under the CBOE's rules.

#### *C. CBOE Rule 3.4*

New CBOE Rule 3.4 sets forth the membership requirements for entities that are not organized under the laws of one of the states of the United States. The Commission believes that the requirement under CBOE Rule 3.4 that a foreign organization register as a broker or dealer pursuant to Section 15 of the Act will help to protect investors and the public interest by ensuring that foreign CBOE members are subject to the same regulatory requirements a U.S. broker-dealers. The Commission also believes that the requirement that foreign members disclose all associated persons and all parents of the organization, including the ultimate individual beneficial owners of organization, will facilitate the CBOE's review of membership applications submitted by foreign organizations and

help the CBOE to ensure that foreign applicants for membership satisfy all of the CBOE's requirements for membership.

The Commission also believes that it is reasonable for the CBOE to clarify that, in addition to satisfying the requirements of CBOE Rule 3.4, a foreign organization must satisfy the other membership qualification requirements under the CBOE's rules and Constitution, as well any additional requirements that the CBOE reasonably deems appropriate. The Commission believes that these provisions will clarify that a foreign organization, like a U.S. applicant for membership, must satisfy all of the CBOE's membership qualification requirements and provide the CBOE with flexibility to impose additional requirements that the CBOE reasonably believes are necessary with respect to foreign members.

In addition, the Commission believes that CBOE Rule 3.4 will facilitate the CBOE's examinations of foreign members, thereby helping the CBOE to enforce compliance by its foreign members with the CBOE's rules and the federal securities law, consistent with Section 6(b)(1) of the Act. The Commission also believes that CBOE Rule 3.4 will facilitate any CBOE or Commission investigation of a foreign member. In this regard, the Commission notes that CBOE Rule 3.4 requires a foreign CBOE member to maintain in English, at a location in the U.S., all of the books and records of the organization relating to its CBOE activities; to permit inspections by the CBOE and the Commission of the foreign operations of the organization related to its securities business; and to be located in a country in which an information sharing agreement, Memorandum of Understanding, or treaty enables the Commission to obtain information about securities trading in that country. In addition, CBOE Rule 3.4 requires that both a foreign member and any of its customers that utilize the organization to execute orders on the CBOE waive any applicable secrecy laws or obtain exemptions from blocking statutes.

The Commission believes that it is reasonable for the CBOE to require a foreign member to keep its financial records in accordance with U.S. accounting standards because all brokers or dealers registered under Section 15 of the Act must maintain their financial records in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). In this regard, the Commission notes that a broker-dealer's net capital is computed under Rule 15c3-1 under the Act, in

<sup>29</sup> CBOE Rule 4.2 states that "[n]o member shall engage in conduct in violation of the Securities Exchange Act of 1934, as amended, rules or regulations thereunder, the Constitution or the Rules of the Exchange, or the Rules of the Clearing Corporation insofar as they relate to the reporting or clearance of any Exchange transactions, or any written interpretation thereof. Every member shall so supervise persons associated with the member as to assure compliance therewith."

accordance with U.S. GAAP. Accordingly, requiring a foreign member to maintain its financial records in accordance with U.S. GAAP will help the CBOE to monitor the financial status of foreign members and ensure their compliance with Rule 15c3-1 under the Act, and with Section 6(c)(3)(A) of the Act, which section provides, in part, that a national securities exchange may deny membership to, or condition the membership of, a registered broker or dealer if the broker or dealer does not meet the standards of financial responsibility prescribed by the rules of the exchange.

The Commission believes that the requirements under CBOE Rule 3.4 that a foreign member appoint a process agent in Illinois and agree to submit to the jurisdiction of the federal courts and the courts of Illinois will help a U.S. person involved in a dispute with a foreign CBOE member to pursue any available legal or equitable remedies against the member.

The Commission believes that it is reasonable for the CBOE to require a foreign member to own its CBOE membership. In addition, the Commission believes that it is reasonable for the CBOE to provide consistency with CBOE Rule 3.3, Interpretation and Policy .01 by providing in CBOE Rule 3.4, Interpretation and Policy .01 that the CBOE will deem a foreign member organized as a limited liability company to be a corporation for purposes of eligibility for membership.

#### *D. CBOE Rule 3.5*

The Commission finds that the proposed changes in CBOE Rule 3.5 will clarify the CBOE's membership requirements by indicating the criteria for denial or conditioning membership or association are applicable only to broker-dealer applicants. In addition, the Commission believes that the proposed net worth requirements will strengthen the CBOE's membership requirements and help the CBOE to deny or condition membership to individuals and organizations that have not demonstrated the ability to assume the economic responsibilities attendant to CBOE membership. In addition, the Commission believes that it is reasonable for the CBOE to indicate that it will not use an applicant's failure to pay debts that have been discharged in bankruptcy as a ground for denial or conditioning approval of the application, while reserving the right to consider fraudulent activity or other violations of just and equitable principles of trade in connection with a bankruptcy proceeding in determining

whether to deny or condition approval of an applicant. The Commission also believes that it is reasonable for the CBOE to state in CBOE Rule 3.5 that any Membership Committee decision to deny or condition membership must be consistent with the provisions of CBOE Rule 3.5 and the Act.

#### *E. CBOE Rule 3.6*

The Commission believes that CBOE Rule 3.6 will clearly identify the associated persons that must be disclosed to the CBOE and approved by the Membership Committee and help to ensure that the Membership Committee has an opportunity to review the qualifications of those associated persons. CBOE Rule 3.6 also makes clear that no person may become associated with a member organization in the capacity of a direct owner or executive officer that is, or would be, required to be disclosed on Form BD unless and until the Membership Committee approves the association.

#### *F. CBOE Rule 3.7*

The Commission believes that the proposed changes in CBOE Rule 3.7 identify with greater specificity the documents that member organizations and member organization applicants must file with the CBOE, as well as the additional documents that member organizations and member organization applicants must file with the CBOE upon request. Accordingly, the Commission believes the proposed changes will more clearly notify member organizations and applicants of the documents they must file with the CBOE.

The Commission believes that the requirement that member organizations and applicants file, upon request, documents reasonably related to the member's business or proposed business on the CBOE and documents relating to the registration, governance, capital structure or ownership of the organization, will facilitate the CBOE's review of membership applications and help the CBOE to examine and verify the qualifications of an applicant for membership, consistent with Section 6(c)(3) of the Act. The requirements also should help the CBOE to enforce compliance by its members and associated persons with the Act, and the rules and regulations thereunder, and the rules of the CBOE, consistent with Section 6(b)(1) of the Act.

The Commission also believes that it is reasonable for the CBOE to add provisions in CBOE Rule 3.7 notifying members and applicants of their obligation to comply with Section 17(f) under the Act and Exchange Act Rule

17f-2. Similarly, the Commission believes that it is reasonable for the CBOE to notify members and member applicants that are registered brokers or dealers of their obligation to file and keep current Form BD and to require members and member applicants that are not registered broker-dealers to file with the CBOE and keep current a list of associated persons that must be approved by the Membership Committee pursuant to CBOE Rule 3.6(b).

The Commission believes that CBOE Rule 3.7, Interpretation .01, which specifies the documents that a limited liability company must file with the Membership Department, will clarify the CBOE's requirement with respect to limited liability companies and notify limited liability companies of the documents they must file with the Membership Department.

#### *G. CBOE Rule 3.8*

The Commission believes that the proposed changes to CBOE Rule 3.8 will clarify the CBOE's rules regarding nominees and individual members who register memberships for member organizations. By specifying requirements both for member organizations that are not lessors of memberships and for member organizations that are leasing memberships, the proposal helps to ensure that the CBOE will know which individual of a member organization will represent the organization in matters before the CBOE. In addition, by clarifying the procedures applicable to nominees and individual members who register memberships for member organization, the proposed changes should better inform CBOE member organizations and prospective member organizations of the requirements for obtaining these statuses, as well as the rights and obligations of nominees and individual members who register memberships for member organizations.

The Commission notes that the proposal provides that the nominee of a member organization that is not acting as a lessor, other than a member approved solely to transact business with the public, and an individual that registers a membership for a member organization, must have an authorized floor function. In addition, the proposal states that a nominee or individual who registers a membership for a member organization must be materially involved in the daily operation of the CBOE business activities of the member organization for which the person is a nominee or has registered his or her membership. The Commission believes that these requirements will help to

ensure that qualified persons represent member organizations in matters relating to the CBOE. In addition, the Commission believes that the requirements are consistent with Sections 6(c)(3)(A) and (B) of the Act, which provide that a national securities exchange may prescribe standards of training, experience, and competence for members or persons associated with its members.

The Commission believes that it is reasonable for the CBOE to clarify in CBOE Rule 3.8(d) that neither a nominee nor an individual member who has registered a membership for a member organization will have any personal liability, solely by virtue of being a nominee or an individual member who has registered a membership for a member organization, to the CBOE or to other members for transactions made by the nominee or individual member on behalf of the member organization. Similarly, the Commission believes that it is reasonable for the CBOE to clarify in CBOE Rule 3.8, Interpretation and Policy .01, that CBOE Rule 3.8(d) is not intended to limit any obligations between a nominee or individual member who has registered a membership for a member organization and the member organization, any responsibility that a nominee or individual member who has registered a membership for a member organization may have for obligations of the member organization by virtue of a contractual obligation or ownership relationship, or the CBOE's ability to sanction or take other remedial measures against a nominee or an individual member who has registered a membership for a member organization. The Commission believes that these changes will help to clarify the rights and obligations of members and nominees.

The Commission also believes that it is reasonable for the CBOE to provide that: (1) A member organization may designate one or more inactive nominees; (2) an inactive nominee of a member organization must become an effective nominee of the member organization, with authorized floor functions, within 90 days of approval for membership; and (3) an individual may be an inactive nominee of only one member organization. The Commission believes that these provisions will help to clarify the CBOE's policies, ensure that member organizations have an appropriate number of inactive nominees, and ensure that only qualified persons will be eligible to serve as nominees.

#### *H. CBOE Rule 3.9*

The Commission believes the proposed changes to CBOE Rule 3.9 will clarify the CBOE's application procedures and requirements by codifying several existing CBOE policies, thereby helping to notify members and applicants for membership of the CBOE's application procedures and requirements and helping to ensure compliance with those rules. In this regard, the Commission notes that the proposal codifies in CBOE Rule 3.9 requirements related to the CBOE's Floor Member Qualification Exam, which the Commission has approved previously,<sup>30</sup> as well as the requirement currently set forth in the CBOE's application materials (the Form U-4) that an applicant promptly update its application if any of the information contained in the application becomes inaccurate or incomplete after the date the applicant submits the materials to the CBOE and prior to approval of the application. The Commission believes that it is reasonable for the CBOE to codify these existing requirements in CBOE Rule 3.9.

CBOE Rule 3.9(e) clarifies the CBOE's use of posting periods for membership applications, applications to change a membership capacity status, and applications to change clearing members. CBOE Rule 3.9(e) also allows the Membership Committee to implement a posting requirement for other types of applications and to shorten or waive a required posting period. The Commission believes that it is reasonable for the CBOE to codify its posting requirements to notify members and membership applicants of the requirements. The Commission believes that the posting periods should provide CBOE members with an opportunity to provide the CBOE with comments and information relevant to an application, including comments relating to an applicant's fitness for membership. In addition, the Commission believes that providing the Membership Committee with the flexibility to implement a posting period for other types of applications and to reduce or waive a posting period will help the Membership Committee to utilize the posting requirements effectively.

CBOE Rule 3.9(f) makes clear that the Membership Department typically does not investigate an individual member applicant who was an individual member within the prior six months, since the person recently had been a CBOE member. CBOE Rule 3.9(f) also

indicates that the Membership Department will investigate associated persons that the Membership Committee must approve pursuant to CBOE Rule 3.6(b), rather than all persons associated with an organization, as required currently under CBOE Rule 3.9(c)(1). In addition, CBOE Rule 3.9(f) states that the Membership Department may investigate any other person or organization that submits an application pursuant to CBOE Rule 3.9(a).

The Commission believes that CBOE Rule 3.9(f), as amended, will ensure that the Membership Department conducts necessary investigations of applicants for membership and of associated persons that the Membership Committee must approve pursuant to CBOE Rule 3.6(a), thereby helping to ensure that only qualified individuals and organizations become CBOE members or approved associated persons. The Commission believes that the provision in CBOE Rule 3.9(f) indicating that the Membership Department may conduct a less extensive review of an individual member applicant who was an individual member within the previous six months will provide the Membership Department with flexibility in reviewing the applications of individuals whom the Membership Department has investigated recently. The Commission notes, in addition, that the CBOE will conduct a more extensive review of an individual member applicant who was a member within the previous six months if such a review is warranted.<sup>31</sup> The Commission believes that the provision in CBOE Rule 3.9(f) allowing the Membership Department to investigate any other person or organization that submits an application pursuant to CBOE Rule 3.9(a) clarifies the Membership Department's authority and ensures that the Membership Department will have the flexibility to conduct necessary investigations.

The Commission believes that the requirements in CBOE Rule 3.9 applicable to a member seeking to change the clearing member that guarantees the member's CBOE transactions will help to ensure the financial integrity of CBOE members. Specifically, CBOE Rule 3.9 requires a member seeking to change clearing members to submit an application to the Membership Department, along with a financial statement setting forth the applicant's assets and liabilities. In addition, the application to change clearing members must be posted, unless the clearing member(s) that will not longer guarantee the applicant's CBOE transactions waives the posting

<sup>30</sup> See Membership Qualification Exam Order, *supra* note 18.

<sup>31</sup> See June 9 Conversation, *supra* note 17.

requirement. The Commission believes that the posting requirement will allow the clearing member(s) that will no longer clear the applicant's CBOE transactions, and other members, to notify the Membership Department of outstanding liabilities that may be relevant to the applicant's qualifications for membership. In addition, the information regarding the applicant's financial standing should help the new clearing member to manage the risk associated with the applicant's trading activities.

The Commission believes that CBOE Rule 3.9, Interpretation and Policy .02, which allows the Membership Committee to disapprove the name change application or membership application of an organization with a name that is confusingly similar to the name of an existing member organization will help to avoid confusion and help the CBOE to maintain a fair and orderly market.

#### *I. CBOE Rule 3.10*

The Commission finds that the provisions in CBOE Rule 3.10 requiring an applicant for membership, for certain membership statuses, and for approved associated person status to become effective in the status within 90 days will clarify the CBOE's rules and notify members of the CBOE's requirements. In addition, the Commission believes that it is reasonable for the CBOE to provide a lessor with six months to become effective in the status to allow lessors sufficient time to purchase a membership.

#### *J. CBOE Rule 3.11*

The Commission believes that the proposal to amend CBOE Rule 3.11 to reflect the CBOE's current procedures for notifying the CBOE membership of the effectiveness of any membership, membership status, or associated person status will help to inform members of the CBOE's current practice for providing such notifications. The Commission believes that it is reasonable for the CBOE to eliminate the requirement in CBOE Rule 3.11 that the CBOE mail notices to members because the Exchange Bulletin now is forwarded to all members and will accomplish the same purpose as mailing notices to members. In addition, the Commission believes that it is reasonable for the CBOE to eliminate the requirement that notices of approved statuses be posted on the CBOE's bulletin board because the notices relate to statuses that have been approved, rather than to pending applications on which members may wish to submit comments.

#### *K. CBOE Rule 3.12*

The Commission finds that the provisions of CBOE Rule 3.12 that restate current provisions of the CBOE's rules do not raise new regulatory issues. The Commission believes that the new reference in CBOE Rule 3.12 to an Authorization to Sell will help to ensure clarity and consistency in the CBOE's rules.

#### *L. CBOE Rule 3.13*

The Commission believes that the proposed amendments to CBOE Rule 3.13 will help to notify members of the CBOE's requirements and procedures for the purchase of memberships, thereby facilitating compliance with the CBOE's rules. In addition, the Commission finds that the provisions limiting the purchase of memberships to those approved by the Membership Committee to be an owner or lessor will help to ensure that only qualified individuals and organizations purchase CBOE memberships. The Commission finds that the provision requiring payment for a membership within two business days will clarify the CBOE's rule and help to facilitate the orderly transfer of CBOE memberships.

#### *M. CBOE Rule 3.14*

The Commission believes that amending CBOE Rule 3.14(a) to provide that the lowest offer to sell a membership will be published in the Exchange Bulletin may better inform members of sale offers and facilitate the sale of memberships.

The Commission believes that it is reasonable for the CBOE to amend CBOE Rule 3.14(b) to apply its provisions to lessees as well as members as a means to clarify the CBOE's authority to sell a membership if the lessee satisfies one of the conditions listed in CBOE Rule 3.14(b).

The Commission believes that amending CBOE Rule 3.14(c)(iii) to require a transferor to maintain an interest at least equal in value to the current market price of the membership will help to ensure that a transferor maintains a substantial ownership interest in the organization to which the transferor transfers his or her membership. The Commission believes that the proposed change will help to preserve the original intent of this provision in light of the increase in prices for CBOE memberships.

The Commission believes that it is reasonable for the CBOE to adopt the Authorization to Sell procedures specified in CBOE Rule 3.14(d). As the CBOE notes, CBOE Rule 3.14(d) expands upon the current provisions of

CBOE Rule 3.15, Interpretation and Policy .01, which allow the CBOE to recognize and give effect to a valid instrument by which a member, in consideration of a loan or guarantee of a loan by another member for the purpose of purchasing a membership, has authorized the lending or guaranteeing member to sell that membership.

The Commission believes that CBOE Rule 3.14(d) expands upon and strengthens the CBOE's current rule by clarifying the rights and obligations of both a grantee and a membership owner that grants an Authorization to Sell. For example, CBOE Rule 3.14(d) states that a membership owner and a grantee may enter into a written contract setting forth the circumstances under which the grantee may exercise its authority to sell the membership. In addition, CBOE Rule 3.14(d) provides that any breaches of the written contract may be redressed through arbitration under Chapter XVIII of the CBOE's rules or other means permitted under Chapter XVIII. CBOE Rule 3.14(d) also clarifies, among other things, that a membership owner may grant only one Authorization to Sell a particular membership; that a grantee shall have all authority relating to the sale of a membership; and that a grantee shall have a security interest, which the grantee may act to perfect, in any proceeds from the sale of the membership that the grantee is entitled to receive pursuant to CBOE Rule 3.15(b). The Commission believes that the Authorization to Sell provisions should function with the revised claims process established in CBOE Rule 3.15, as discussed below, to provide an orderly and efficient procedure for resolving claims among CBOE members.

#### *N. CBOE Rule 3.15*

The Commission believes that the revised membership claims process will promote just and equitable principles of trade and remove impediments to and perfect the mechanism of a free and open market by enhancing the CBOE's procedures for resolving claims between members. The Commission believes that the revised membership claims process is a reasonable effort by the CBOE to reduce the administrative burdens associated with its current claims process and to provide members with a fair and efficient means for resolving claims between the grantee of an Authorization to Sell and the membership owner who granted the Authorization to Sell.

CBOE Rule 3.15 revises the membership claims process by providing that the only possible claimant under the membership claims

process will be the grantee of an Authorization to Sell. Specifically, CBOE Rule 3.15 provides, among other things, that the grantee must submit in writing within two business days any claims related to the CBOE business activities of a member whose membership was sold.<sup>32</sup> The member whose membership was sold has five business days from the date of the sale to acknowledge or contest the claims. Contested claims will be resolved through arbitration under Chapter XVIII of the CBOE's rules or through other means permitted by Chapter XVIII.

Although the CBOE, the OCC, and other CBOE members will not be able to pursue claims against a member that has granted an Authorization to Sell under the revised claims process, they will continue to have the ability to pursue claims against the member who has granted an Authorization to Sell through arbitration under Chapter XVIII of the CBOE's rules or through other means permitted under Chapter XVIII. Accordingly, the Commission believes that the revised membership claims process, together with the CBOE's arbitration facilities, will provide fair procedures for the resolution of disputes involving CBOE members, the CBOE, or the OCC when an Authorization to Sell has been granted.

#### *O. CBOE Rule 3.16*

The Commission believes that the proposed changes to CBOE Rule 3.16 will help to notify members of the circumstances under which a CBOT exerciser membership terminates. In addition, the proposed changes will clarify the CBOE's rules by moving provisions relating to leased memberships from CBOE Rule 3.16 to CBOE Rule 3.17.

#### *P. CBOE Rule 3.17*

The Commission believes that new CBOE Rule 3.17 will clarify the requirements, rights, and obligations applicable to leased memberships. For example, CBOE Rule 3.17 makes clear that the CBOE must pre-approve a lease; that the CBOE will bear no liability to a lessor or lessee in connection with its review and approval of a lease agreement; and that the CBOE may specify additional provisions that must be included in a membership lease, in addition to those designated in CBOE Rule 3.17. CBOE Rule 3.17 also clarifies

that a lessee must file a lease and any amendments to the lease with the Membership Department and notify the Membership Department of any termination of the lease before the termination becomes effective.

Consistent with the revised membership claims process, CBOE Rule 3.17 indicates that a lessor will have no liability for claims against a lessee solely by virtue of being a lessor of the membership. However, CBOE Rule 3.17 also states that this provision is not intended to limit or define any responsibility a lessor may have for claims against a lessee by virtue of a contractual obligation or ownership relationship between the lessor and lessee beyond the lease of the membership. Similarly, to provide consistency with the revised membership claims process, the Exchange is eliminating the current provision of CBOE Rule 3.16(b) which states that any division of rights and responsibilities between the lessor and lessee will not affect the lessor's obligation to pay all amounts due to the CBOE.

CBOE Rules 3.17(e) and 3.17(f) contain provisions that apply when a lessor sells or transfers a membership that is being leased. Specifically, CBOE Rule 3.17(e) requires a purchaser or transferee of a membership that is being leased to lease the membership to the lessee pursuant to the terms of the existing lease agreement for a period of 20 business days following the date of the transfer to the purchaser or transferee. The Commission believes that the 20-day period will provide a lessee with time to obtain the lease of another membership, thereby helping to ensure that a lessee will be able to continue its business uninterrupted if the membership it is leasing is sold or transferred during the term of the lease. By allowing a lessee to continue in business without interruption, the proposal will protect lessees and contribute to the maintenance of a fair and orderly market on the CBOE.

CBOE Rule 3.17(f) clarifies the application of CBOE Rule 3.17(e) by specifying the allocation of amounts paid under a lease agreement when the membership being leased is sold or transferred. The Commission believes that CBOE Rules 3.17(e) and 3.17(f) will notify members of the rights and obligations of a lessor, lessee, and transferee when a leased membership is sold or transferred.

#### *Q. CBOE Rule 3.18*

As described more fully above, the CBOE proposes to revise its procedures for determining whether to permit a

member or associated person who becomes subject to a statutory disqualification to continue in membership or association and, if so, whether to condition such continuance in membership or association. The procedures adopted in new CBOE Rule 3.18 are similar to the procedures set forth in National Association of Securities Dealers ("NASD") Rules 9520 through 9526, which the Commission approved previously.<sup>33</sup> The Commission finds that new CBOE Rule 3.18 is consistent with Section 6(b)(5) in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

Specifically, the Commission believes that CBOE Rule 3.18 should enhance investor protection by enabling more rapid identification of statutorily disqualified individuals. In this regard, the Commission notes, for example, that CBOE Rule 3.18 requires a member or associated person that becomes subject to a statutory disqualification to submit an application seeking to continue in membership or association to the Membership Department within 10 days of becoming subject to a statutory disqualification, rather than within 30 days of becoming subject to a statutory disqualification, as provided under current Policy .02 sets forth a member's obligation to notify the Membership Department of the name of an associated person who is or becomes subject to a statutory disqualification, the person's capacity with the member, and the nature of the statutory disqualification.

CBOE Rule 3.18 further expedites the CBOE's current procedures by requiring a panel of the Membership Committee to hold a hearing within 14 days following the receipt of an application to continue in membership or association, or the initiation of a proceeding by the CBOE if a member or associated person subject to a statutory disqualification fails to submit the required application to continue in membership or association. Following the hearing, the panel will present its recommended decision to the Membership Committee, which may ratify or amend the decision. The Membership Committee will present its decision to the Executive Committee, which may determine within seven days to review the Membership Committee's

<sup>32</sup> As noted above, CBOE Rule 3.15 defines claims related to CBOE business activities to include, among other things, claims associated with CBOE transactions and loans or loan guarantees for the purpose of purchasing a CBOE membership. The Exchange will determine whether a claim is related to CBOE business activities.

<sup>33</sup> See Securities Exchange Act Release No. 40853 (December 28, 1998), 64 FR 555 (January 5, 1999) (order approving File No. SR-NASD-98-57).



decision. If the Executive Committee does not order a review of the Membership Committee's decision, the Membership Committee's decision will become the final decision of the CBOE. If the Executive Committee orders a review of the Membership Committee's decision, the Executive Committee or a panel of the Executive Committee, whose decision must be ratified by the Executive Committee, will conduct the review. The Executive Committee's decision, which must be in writing, will become the final decision of the CBOE.

The Commission believes that CBOE Rule 3.18 will streamline the CBOE's procedures and allow the CBOE to proceed more expeditiously to discontinue or condition the membership or association of a member or associated person who is or becomes subject to a statutory disqualification. The CBOE's revised procedures should protect investors and the public interest by helping to ensure that CBOE members and associated persons are qualified and eligible for membership.

The Commission believes that it is reasonable for the CBOE to provide in CBOE Rule 3.18, Interpretation and Policy .01, that the CBOE may waive the provisions of CBOE Rule 3.18 when a proceeding is pending before another self-regulatory organization to determine whether to permit an associated person to continue in membership with the member notwithstanding a statutory disqualification, and to provide that, if the CBOE waives the provisions of CBOE Rule 3.18, the Department of Financial and Sales Practice Compliance will determine whether the CBOE will concur in any filing made under Rule 19h-1 of the Act by another self-regulatory organization. The Commission finds that this provision is consistent with Rule 19h-1 under the Act.

#### *R. CBOE Rule 3.19*

The Commission finds that new CBOE Rule 3.19, a revised version of current CBOE Rule 3.17, will clarify that a member's membership status will terminate automatically when the member does not possess a membership and when a member organization has no nominee or member who has registered a membership for the member organization. The Commission believes that new CBOE Rule 3.19 will help to notify members of the CBOE's rules regarding the termination of membership status and provide consistency with the CBOE's requirement that a member organization select a nominee or member who has registered a membership for the member

organization to represent the organization in all matters relating to the CBOE.

#### *S. CBOE Rule 3.20*

The Commission believes that the new requirements in CBOE Rule 3.20 that a member organization provide written notice to the Membership Department and the Department of Financial and Sales Practice Compliance of the adoption of a plan of liquidation or dissolution, and any actual liquidation or dissolution, will protect investors and the public interest by helping the CBOE to monitor the status and financial condition of its members.

#### *T. CBOE Rule 3.21*

The Commission believes that the deletion from CBOE Rule 3.21 of provisions allowing the CBOE to withhold the distribution of the proceeds of a sale of a membership if the seller is not current in the payment of CBOE fees or the submission of various filings will ensure that CBOE Rule 3.21 is consistent with the CBOE's revised claims process.

#### *U. CBOE Rules 1.1(hh), 3.20, 3.21, 3.22, 3.22A, and 6.20*

The Commission believes that it is reasonable for the CBOE to delete CBOE Rules 1.1(hh), 3.20, 3.21, 3.22, 3.22A, and 6.20, Interpretation and Policy .03, which relate to government securities options permits, because all of the government securities options permits have expired. Accordingly, the Commission believes that eliminating these rules will clarify the CBOE's rules.

#### *V. CBOE Rule 3.25*

The Commission believes that the proposed changes to CBOE Rule 3.25 will clarify the CBOE's rules regarding a membership held in trust, thereby facilitating compliance with the CBOE's rules and requirements for memberships held in trust. Among other things, CBOE Rule 3.25, as amended, clarifies that a member transferring a membership into a trust must transfer the membership into a living trust. In addition, CBOE Rule 3.25 clarifies that the CBOE will deem the membership to have reverted to the Trust Member if the membership is released from the trust, the trust terminates, or the trust agreement no longer complies with the requirements of CBOE Rule 3.25. The requirement that a Trust Member submit to the Membership Department amendments to the trust agreement, any release of the membership out of trust, and any termination of the trust will help the CBOE monitor the status of a

membership held in trust and determine whether a trust continues to satisfy the requirements of CBOE Rule 3.25.

#### *W. CBOE Rule 3.27*

The Commission believes that it is reasonable for the CBOE to amend CBOE Rule 3.27 and Regulatory Bulletin 00-37 to provide consistency with the revised membership claims process.

#### *X. CBOE Rule 3.28*

The Commission believes that new CBOE Rule 3.28 will provide necessary flexibility in the administration of the rules in Chapter III of the CBOE's rules by allowing the Membership Committee and/or the Membership Department to extend any time limit imposed under Chapter III of the CBOE's rules, relating to membership. The Commission notes that new CBOE Rule 3.28 is similar to current CBOE Rule 17.13, which allows the CBOE to extend time limits for the submission of materials required under Chapter XVII of the CBOE's rules.

#### *Y. CBOE Rule 3.29*

The Commission believes that new CBOE Rule 3.29 will facilitate the orderly administration of the CBOE's rules by clarifying that the Membership Committee and/or the Membership Department may exercise all of the authority granted to the CBOE under Chapter III of the CBOE's rules. In addition, CBOE Rule 3.29 will clarify the Membership Committee's ability to delegate authority to the Membership Department, thereby helping to ensure that the Membership Committee will be able to focus its attention on more significant membership applications and approvals.

#### *Z. CBOE Rule 6.76A*

The Commission believes that the automated billing process established in CBOE Rule 6.76A will streamline the processing and payment of bills for brokerage services performed by floor brokers and order service firms. The Commission believes that new CBOE Rule 6.76A will establish an efficient and effective automated billing process that will facilitate the prompt payment of amounts market makers owe to floor brokers and order service firms while providing market makers with an opportunity to review and dispute bills submitted by floor brokers and order service firms. In this regard, CBOE Rule 6.76A states that a market maker that disputes a bill may pursue a claim against the floor broker or order service firm in arbitration under Chapter XVIII of the CBOE's rules or through other means permitted by Chapter XVIII. In addition, the Commission notes that the

CBOE may discipline a floor broker or order service firm for violating CBOE Rule 4.6 by submitting a false statement to the CBOE if the floor broker or order service firm improperly instructs the CBOE to bill a market maker for brokerage fees which the floor broker or order service firm is not entitled to receive.

The Commission believes that CBOE Rule 6.76A provides a detailed description of the automated billing system that will notify members of the procedures and obligations associated with the new billing system, including monthly deadlines for submitting bills and instructions under the new procedures. In addition, CBOE Rule 6.76A(a)(vii) provides that a clearing member may instruct the CBOE's accounting department not to draft the clearing member for brokerage fees that would cause the market maker to have a negative balance in the market maker's account at the clearing member, thereby clarifying that a clearing member will not serve as a guarantor for a market maker's brokerage service bills. CBOE Rule 6.76A also establishes procedures for making deductions from a market maker's account if a clearing member instructs the accounting department not to draft the clearing member pursuant to CBOE Rule 6.76A(a)(vii) and the account subsequently has a positive balance.

The Commission notes that the automated billing system established in CBOE Rule 6.76A is similar to the Integrated Billing System established in CBOE Rule 3.23 for CBOE invoices, which the Commission has approved.<sup>34</sup>

The Commission believes that the fees that the CBOE proposes to assess to help to defray the CBOE's cost of administering the automated billing process provides for the equitable allocation of reasonable dues, fees, and other charges among members, consistent with Section 6(b)(4) of the Act.

#### *AA. CBOE Rules 6.72, 6.78 and 8.5*

The Commission believes that it is reasonable for the CBOE to amend CBOE Rules 6.72, 6.78, and 8.5 to provide that the CBOE will post notice of a clearing member's revocation of its letter of authorization only at the request of the clearing member because, according to the CBOE, most revocations are routine and arise because a member is terminating from membership or is changing the clearing

member that guarantees the member's Exchange transactions.

The amendments to CBOE Rule 6.72 also clarify the rules applicable to letters of authorization by stating that: (1) A revocation will not relieve a clearing member of responsibility for transactions guaranteed prior to the effective date of the revocation; and (2) a floor broker may have only one letter of authorization guarantee from a clearing member in effect at a time. The Commission believes that these amendments will help to notify members of the rules applicable to floor brokers' letters of authorization.

In addition, the Commission believes that it is reasonable for the CBOE to amend CBOE Rule 8.5 to clarify that a market maker that clears transactions through more than one clearing member must have a letter of guarantee issued by each clearing member to cover the CBOE transactions executed by the market maker through the clearing member. The Commission believes that this amendment to CBOE Rule 8.5 will protect investors and the public interest by helping to ensure the financial integrity of market makers.

The Commission also believes that it is reasonable for the CBOE to amend CBOE Rule 8.5, Interpretation and Policy .04, to provide that the CBOE will notify each clearing corporation that has approved a letter of guarantee for a market maker of the issuance and revocation, if applicable, of all other letters of guarantee issued to the market maker in respect of transactions subject to the rules of any other clearing corporation. The Commission believes that the proposed change will help to inform a clearing corporation of the financial status of a market maker for whom the clearing corporation has approved a letter of guarantee.

#### *BB. CBOE Rule 8.9*

The Commission believes that new Interpretation and Policy .08 to CBOE Rule 8.9 will clarify the obligations of members by stating that each participant in a joint account will be jointly and severally liable for any losses incurred by the joint account. In addition, Interpretation and Policy .08 will provide consistency with CBOE Rule 3.8(d) by indicating that when a joint account participant that is the nominee of a member organization, or an individual who has registered his or her membership for a member organization, and the participant is not acting as an independent market maker pursuant to CBOE Rule 3.8(f), the member organization, rather than the participant, will be liable for losses incurred by the joint account.

#### *CC. CBOE Rules 9.3, 10.11, and 15.1*

The Commission believes that new Interpretation and Policy .01 to CBOE Rule 9.3 will clarify an existing CBOE requirement by stating that the application that associated persons who are representatives must file with the CBOE is the Form U-4. Similarly, Interpretation and Policy .01 will set forth the existing requirement that a person required to file Form U-4 also must file any required amendments to Form U-4. The Commission believes that the proposed changes will help to notify associated persons of their obligations with respect to Form U-4.

The Commission believes that the proposed amendment to CBOE Rule 10.11 will provide clarity and consistency in the CBOE's rules by referring to the claims resolution procedures established in CBOE Rule 3.15. Similarly, the proposed amendments to Interpretation and Policy .01 to CBOE Rule 15.1 will revise references to specific CBOE rules to reflect the changes to the CBOE's membership rules.

#### *DD. CBOE Rule 18.2*

The Commission believes that CBOE Rule 18.2, Interpretation and Policy .01, which will ensure that clearing members receive notice of proceedings involving disputed trades, is reasonable because it will help to keep clearing members apprised of proceedings involving members whose trades the clearing member has guaranteed.

#### *EE. CBOE Rules 6.72, 24A.15, 26.11, 26.13, and 30.74*

The Commission believes that the conforming changes to CBOE Rules 6.72, 24A.15, 26.11, 26.13, and 30.74, will provide clarity and consistency in the CBOE's rules by deleting references to the current membership claims process.

#### *FF. Membership Fee Circular*

The Commission believes that the amendments to the Circular will clarify the Circular by limiting the Circular solely to information regarding membership fees while moving the deleted portions of the Circular to the CBOE's rules. The Commission believes that the revised fees set forth in the Circular provide for the equitable allocation of reasonable dues, fees, and other charges among members, consistent with Section 6(b)(4) of the Act.

#### *GG. Special Members*

The Commission believes that the deletion of references to special members in CBOE Rules 3.12, 3.14,

<sup>34</sup> See Securities Exchange Act Release No. 20962 (May 15, 1984), 49 FR 21586 (May 22, 1984) (order approving File No. SR-CBOE-84-10).

3.16, 6.5, and 9.1 will clarify the CBOE's rules because all special memberships on the CBOE have expired.<sup>35</sup>

#### *HH. Effectiveness of the Proposed Rule Change*

The Commission believes that it is reasonable for the proposed rule change to become effective 30 days from the date of its approval by the Commission. The Commission believes that the 30-day period will provide the CBOE with an opportunity to notify the Exchange's membership of the effectiveness of the rule change.

The Commission finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 3 strengthens the CBOE's proposal by providing additional requirements for foreign organizations seeking to become CBOE members. Accordingly, the Commission believes that granting accelerated approval of Amendment No. 3 is appropriate and consistent with Sections 6(b)(5) and 19(b)(2) of the Act.<sup>36</sup>

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-CBOE-99-15 and should be submitted by August 18, 2000.

#### **V. Conclusion**

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>37</sup> that the

proposed rule change (SR-CBOE-99-15), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>38</sup>

**Jonathan G. Katz,**

*Secretary.*

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**BILLING CODE 8010-01-M**

#### **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-43059; File No. SR-Phlx-00-58]**

#### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Certain PACE Rule Provisions**

July 20, 2000.

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 June 30, 2000, the Philadelphia Stock Exchange, Inc. ("Phlx" 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 Phlx. On July 18, 2000, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Exchange has designated the proposed rule change as constituting a "non-controversial" rule change under paragraph (f)(6) of Rule 19b-4 under the Act,<sup>4</sup> which renders the proposal effective upon receipt of this filing by the Commission.<sup>5</sup> The Commission is publishing this notice to solicit

<sup>38</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.

<sup>3</sup> In Amendment No. 1, the Exchange modified its proposed change to the text of Supplementary Material .10(a)(i). The modification clarifies that qualifying marketable limit orders will continue to be executed at the price quoted in the Phlx Automated Communication and Execution System, whether or not executed automatically. See Letter from Edith Hallahan, Deputy General Counsel, Phlx, to Steven Johnston, Special Counsel, Division of Market Regulation, dated July 17, 2000 ("Amendment No. 1").

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> The Exchange has represented that the proposed rule change: (i) will not significantly affect the protection of investors or the public interest; (ii) will not impose any significant burden on competition; and (iii) will not become operative for 30 days after the date of this filing, unless otherwise accelerated by the Commission. The Exchange also has provided at least five business days notice to the Commission of its intent to file this proposed rule change, as required by Rule 19b-4(f)(6) under the Act. *Id.*

comments on the proposed rule change from interested persons.

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

The Phlx, pursuant to Rule 19b-4 under the Act,<sup>6</sup> proposes to implement a change to the Phlx Automated Communication and Execution ("PACE") System. By incorporating two provisions into Phlx Rule 229 (concerning PACE), this change will provide an entering member organization with additional elections with respect to certain features of PACE similar to those currently provided for in the Rule. Specifically, the language "unless the entering member organization otherwise elects" is proposed to be added to both Supplementary Material .10(a)(i) and (ii).

The proposed change to Supplementary Material .10(a)(i) provides that round-lot orders up to 599 shares, and the round-lot portion of PRL,<sup>7</sup> limit orders up to 599 shares, that are entered at the PACE Quote, shall be executed at the PACE Quote.<sup>8</sup> This proposal would codify that such execution guarantee can either be provided by the PACE System automatically or by the specialist, at the election of the entering member. This amendment does not change the fundamental principle of PACE that the specialist must provide the PACE Quote to eligible orders.

Second, the revision would permit the entering member organization to elect whether certain eligible non-marketable limit orders will be executed via PACE in accordance with the "primary market print protection" provision set forth in Supplementary Material .10(a)(ii) of the PACE Rule.

#### **II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, Phlx 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

<sup>6</sup> 17 CFR 240.19b-4.

<sup>7</sup> The first paragraph of Rule 229 defines a PRL as a combined round-lot and odd-lot order.

<sup>8</sup> The PACE Quote is defined in Rule 229 as the best bid/ask quote among the American, Boston, Cincinnati, Chicago, New York, Pacific or Philadelphia Stock Exchange, or the Intermarket Trading System/Computer Assisted Execution System ("ITS/CAES") quote, as appropriate.

<sup>35</sup> See note 22, *supra*.

<sup>36</sup> 15 U.S.C. 78f(b)(5) and 78s(b)(2).

<sup>37</sup> 15 U.S.C. 78s(b)(2).