



November 26, 2010

Via Electronic Mail

Ms. Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Comment Letter on Proposed Rule Relating to Ownership Limitations and Governance Requirements; File No. S7-27-10; 75 FR 65882 (October 26, 2010)

Dear Ms. Murphy:

Chicago Board Options Exchange, Incorporated ("CBOE") appreciates the opportunity to provide its comments to the Securities and Exchange Commission ("SEC") with respect to the SEC's proposals in the above-referenced release ("Release"). The Release proposes to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") by setting forth proposed ownership limitations and governance requirements ("Proposed Requirements") for security-based swap clearing agencies, security-based swap execution facilities ("SB SEFs"), and national securities exchanges that post or make available for trading security-based swaps. CBOE's affiliate C2 Options Exchange, Incorporated ("C2") also concurs with CBOE's comments in this letter.

The Same Governance and Ownership Requirements Should Be Applied to Both SB SEFs and Exchanges

CBOE strongly believes that the SEC should apply the same governance and ownership requirements to SB SEFs as are and will be applied to exchanges.

As the SEC notes in the Release, SB SEFs have a number of regulatory responsibilities under the Dodd-Frank Act. These responsibilities include, among others, establishing and enforcing rules with respect to the terms and conditions of the security-based swaps traded or processed on or through the SB SEF, any limitations on access to the SB SEF, and the trading procedures to be used in entering and executing orders traded on the SB SEF. They also include monitoring trading on the SB SEF to prevent manipulation, price distortion, and disruptions of the settlement process through surveillance, compliance, and disciplinary practices and procedures. Therefore, it is important to hold SB SEFs to the same governance and ownership standards that are applicable to exchanges to ensure that SB SEFs appropriately prioritize their regulatory obligations.

Additionally, the Dodd-Frank Act contemplates that both exchanges and SB SEFs may list security-based swap contracts and thus compete with one another. Thus, it is crucial that there be a level playing field between both exchanges and SB SEFs and that there be no regulatory disparities that would make it more advantageous to list a security-based swap on an SB SEF as opposed to an exchange. Otherwise, the result will be regulatory arbitrage and the

goal of promoting competition between exchanges and SB SEFs will not be realized. Moreover, it is consistent with the public interest and the underlying intent of the Dodd-Frank Act to facilitate the trading of securities-based swaps on fully-regulated exchanges. To the extent that it is easier to start, operate, and trade on a SB SEF than a registered exchange due to regulatory requirements imposed on the latter, trading in security-based swaps will migrate to the lesser-regulated venues. Yet, SB SEFs present an even greater risk of the key conflict with which the SEC is concerned in issuing the Proposed Requirements: when a small number of participants exercise undue control or influence over an entity trading or clearing a security-based swap.

This concept is not only applicable with respect to governance and ownership standards. The SEC should also take the same approach in its other rule proposals concerning SB SEFs and apply the same standards and requirements to both SB SEFs and exchanges with respect to all aspects of their provision and regulation of a venue for the trading of security-based swap contracts.

Accordingly, CBOE agrees with the SEC's approach in proposed Rule 702 of applying the same proposed governance and ownership requirements to SB SEFs as are to be applied to exchanges that post or make available for trading security-based swaps. However, proposed Rule 702 does not go far enough in this regard. In particular, there are a number of uncodified governance requirements and standards that the SEC has imposed on exchanges that should also be imposed on SB SEFs. While a potential approach is for the SEC to impose those governance requirements and standards on SB SEFs without codifying them as it has done with respect to exchanges, a far better process is to place in the regulations the same governance requirements and standards for SB SEFs as for exchanges. Whatever approach is chosen, what is most important is that SB SEFs be held to the same requirements and standards as the SEC has applied to exchanges whether they are codified or not.

For example, the Release notes that the SEC has required exchanges to limit each non-member of an exchange (alone or together with its related persons) to no more than 40% ownership of the exchange. The Release states that the limit on ownership by non-members is designed in part to provide the SEC and the exchange with the proper tools (such as access to books and records) necessary to carry out the SEC's and the exchange's respective regulatory oversight responsibilities, as well as to mitigate more general conflict concerns between owners' commercial interests and the exchange's regulatory obligations. These same concerns apply equally to SB SEFs and thus the 40% ownership limit should be applied to non-participants of an SB SEF in the same manner that this limit applies to non-members of an exchange. Thus, as with an exchange, an SB SEF would be permitted to have a holding company that owned 100% of the SB SEF as long as the various ownership and voting restrictions were applicable at the holding company level.

The same is true with respect to the SEC's requirement that an exchange limit a member from owning more than 20% of any interest in the exchange, voting or otherwise. There is no reason that an SEF participant should be permitted to own a greater than 20% nonvoting interest in an SB SEF when an exchange member is precluded from owning a greater than 20% nonvoting interest in an exchange.

The governance requirements and standards that the SEC has applied to exchanges that should also be applied to SB SEFs include, among others, the following:

- (1) The governing documents of an SB SEF should provide that each director of the SB SEF, in discharging the director's responsibilities as a member of the board of

directors of the SB SEF, and to the fullest extent permitted by law, shall take into consideration the effect that the director's actions would have on the ability of the SB SEF to carry out the SB SEF's responsibilities under the Securities Exchange Act of 1934, as amended ("Exchange Act").

- (2) The governing documents of an SB SEF should provide that each director, officer, and employee of the SB SEF, in discharging that person's responsibilities as a member of the board of directors of the SB SEF or as an officer or employee of the SB SEF, shall comply with the federal securities laws and the rules and regulations thereunder and shall cooperate with the SEC, and the SB SEF pursuant to its regulatory authority.
- (3) The governing documents of an SB SEF should provide that, to the fullest extent permitted by law, all confidential information pertaining to the regulatory function of the SB SEF (including but not limited to disciplinary matters, trading data, trading practices, and audit information) contained in the books and records of the SB SEF shall: (i) not be made available to any persons other than to those officers, directors, employees, and agents of the SB SEF that have a reasonable need to know the contents thereof; (ii) be retained in confidence by the SB SEF and the officers, directors, employees, and agents of the SB SEF; and (iii) not be used for any commercial purposes.
- (4) Each SB SEF should be required to designate a chief regulatory officer and have the compensation of its chief regulatory officer determined by a committee of the SB SEF's board of directors composed entirely of non-industry directors (referred in the Proposed Requirements as independent directors).
- (5) Each SB SEF should have a committee of the SB SEF's board of directors composed entirely of independent directors that may request at any time that the internal auditor of the SB SEF conduct an audit relating to the regulatory functions of the SB SEF and that shall review all internal audits relating to the regulatory functions of the SB SEF.
- (6) Each SB SEF should have a rule which provides that any revenues received by the SB SEF from fees derived from its regulatory function or regulatory fines will not be used for non-regulatory purposes, but rather, shall be applied to fund the legal and regulatory operations of the SB SEF (including surveillance and enforcement activities), or, as the case may be, shall be used to pay restitution and disgorgement of funds intended for customers (except in the event of liquidation of the SB SEF).
- (7) The governing documents of an SB SEF should provide that no entity may acquire a controlling interest in the SB SEF without the prior approval of the SEC.
- (8) The governing documents of any entity has a controlling interest in an SB SEF should provide that each director of that entity, in discharging the director's responsibilities as a member of the board of directors of that entity, and to the fullest extent permitted by law, shall take into consideration the effect that the director's actions would have on the ability of the SB SEF to carry out the SB SEF's responsibilities under the Exchange Act.

- (9) The governing documents of any entity has a controlling interest in an SB SEF should provide that each director, officer, and employee of that entity, in discharging that person's responsibilities as a member of the board of directors of that entity or as an officer or employee of that entity, shall comply with the federal securities laws and the rules and regulations thereunder and shall cooperate with the SEC, and the SB SEF pursuant to its regulatory authority.
- (10) The governing documents of any entity that has a controlling interest in an SB SEF should provide that each officer, director, and employee of that entity shall give due regard to the preservation of the independence of the regulatory function of the SB SEF and to their obligations under the Exchange Act.
- (11) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the officers, directors, and employees of that entity are prohibited from taking any actions that they reasonably should have known would interfere with the effectuation of any decisions by the board of directors of the SB SEF relating to SB SEF's regulatory functions, including disciplinary matters, or would adversely affect the SB SEF's ability to carry out its responsibilities under the Exchange Act.
- (12) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the entity that has a controlling interest in the SB SEF, its directors, officers, agents, and employees, irrevocably submit to the jurisdiction of the U.S. federal courts, the SEC, and the SB SEF, for the purposes of any suit, action, or proceeding pursuant to U.S. federal securities laws or the rules or regulations thereunder, commenced or initiated by the SEC arising out of, or relating to, the SB SEF's activities (and shall be deemed to agree that the entity that has a controlling interest in the SB SEF may serve as the U.S. agent for purposes of service of process in such a suit, action, or proceeding).
- (13) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the entity that has a controlling interest in the SB SEF, its directors, officers, agents, and employees, waive, and agree not to assert by way of motion, as a defense or otherwise in any such suit, action, or proceeding, any claims that they are not personally subject to the jurisdiction of the U.S. federal courts, the SEC, and the SB SEF, that the suit, action, or proceeding is an inconvenient forum, or that the venue of the suit, action, or proceeding is improper, or that the subject matter thereof may not be enforced in or by such courts or agency.
- (14) The governing documents of any entity that has a controlling interest in an SB SEF should provide that, to the fullest extent permitted by applicable law, all confidential information pertaining to the regulatory function of SB SEF (including but not limited to disciplinary matters, trading data, trading practices, and audit information) contained in the books and records of the SB SEF that comes into the possession of the entity that has a controlling interest in the SB SEF will: (1) not be made available to any persons other than to those officers, directors, employees, and agents of that entity that have a reasonable need to know the contents thereof; (2) be retained in confidence by the officers, directors, employees, and agents of that entity; and (3) not be used for any commercial purposes.

- (15) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the books, records, premises, officers, directors, and employees of that entity shall be deemed to be the books, records, premises, officers, directors, and employees of the SB SEF for purposes of and subject to oversight pursuant to the Exchange Act to the extent that the books, records, premises, officers, directors, and employees of that entity relate to the security-based swap execution facility business of the SB SEF.
- (16) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the books and records related to the security-based swap execution facility business of the SB SEF shall be subject at all times to inspection and copying by the SEC and the SB SEF and shall be kept within the United States.
- (17) The governing documents of any entity that has a controlling interest in an SB SEF should provide that that the entity that has a controlling interest in the SB SEF shall take reasonable steps necessary to cause its directors, officers, and employees, prior to accepting such a position with the entity that has a controlling interest in the SB SEF, to consent in writing to the applicability to them of items (8) - (16) above with respect to their activities related to the SB SEF.
- (18) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the entity that has a controlling interest in the SB SEF shall take reasonable steps necessary to cause its agents, prior to accepting such a position with the entity that has a controlling interest in the SB SEF, to be subject to the items (8) - (16) above with respect to their activities related to the SB SEF.
- (19) The governing documents of any entity that has a controlling interest in an SB SEF should provide that the entity that has a controlling interest in the SB SEF shall comply with the federal securities laws and the rules and regulations thereunder and shall cooperate with the SEC, the SB SEF pursuant to and to the extent of its regulatory authority, and shall take reasonable steps necessary to cause its agents to cooperate with the SEC and, where applicable, the SB SEF pursuant to its regulatory authority, with respect to the agents' activities related to the SB SEF.
- (20) The governing documents of any entity that has a controlling interest in an SB SEF should provide that before any amendment, alteration, or repeal of any provision of the governing documents of that entity may become effective, the amendment, alteration, or repeal must be submitted to the board of directors of the SB SEF, and if the amendment, alteration, or repeal must be filed with or filed with and approved by the SEC, then the amendment, alteration, or repeal will not become effective until filed with or filed with and approved by the SEC, as the case may be.

The SEC has found that these governance requirements and standards are necessary in order to protect and maintain the integrity of the regulatory functions of an exchange and to allow an exchange to carry out its regulatory responsibilities under the Exchange Act. The SEC has also found that these requirements and standards that are applicable to the entities that have a controlling interest in an exchange are necessary to ensure that the activities of these entities

related to the operation of the exchange are consistent with and do not interfere with the regulatory obligations of the exchange and allow the exchange and the SEC to fulfill their regulatory and oversight functions under the Exchange Act. The same reasons that motivated the SEC to apply all of these governance requirements and standards to exchanges and entities that have a controlling interest in an exchange apply with equal force, if not more, to SB SEFs.

CBOE also believes that it should be presumed that an entity has a controlling interest in an SB SEF in this context if the entity has a 20% interest in the SB SEF through either ownership or voting power (as opposed to the 25% presumption in proposed Rule 700(e)). The SEC has recognized a 20% standard with respect to exchanges by precluding exchange members from having greater than a 20% ownership or voting interest in an exchange. The Proposed Requirements further this standard through the inclusion of a proposed 20% ownership and voting limitation on exchange members and SB SEF participants. Thus, the SEC has and continues recognize 20% as a threshold at which concerns exist about minimizing the potential that an entity with an ownership or voting interest in an exchange or SB SEF could interfere with or restrict the ability of the exchange, SB SEF, or SEC to effectively carry out its regulatory responsibilities and other obligations under the Exchange Act and at which limitations should be applied. Accordingly, this same percentage should be applicable in determining when an entity with an ownership or voting interest in an SB SEF is presumed to become subject to the governance requirements and standards noted above that the SEC has applied to entities that have a controlling interest in an exchange. Of course, as is the case under proposed Rule 700(e), this 20% threshold should be just a presumption and having a controlling interest in an exchange or SB SEF may exist at a lower ownership or voting percentage based on the applicable facts and circumstances.

CBOE recognizes that the corporate governance requirements that the SEC has imposed on exchanges are not imposed on alternative trading systems ("ATs"). It would be a mistake, however, for the SEC to use the ATS template for SB SEFs. First, it would undermine the intent of the Dodd-Frank Act to foster exchange trading of security-based swaps to provide an ATS-like venue for the trading of those instruments. Any examination of the equities market structure would clearly demonstrate the siphoning of trades from fully-regulated exchanges to much more lightly regulated ATs. Second, the conflict of interest issues may be even further pronounced for SB SEFs than for ATs trading stocks. Due to the bilateral counterparty nature of swap contracts, there is heightened conflict of interest for the dealers of a swap who own or operate an SB SEF.

Consistent with the foregoing, to the extent that CBOE's other comments below with respect to the Proposed Requirements as they relate to exchanges would be applicable to equivalent provisions applicable to SB SEFs, CBOE would support the same requested change or clarification being made with respect the SB SEF provisions.

An Exchange Nominating Committee Should Be Required to Be Composed of a Majority of Independent Directors Instead of Solely Independent Directors

CBOE believes that the SEC should amend proposed Rule 702(f)(1) to provide that the nominating committee of an exchange be composed of a majority of independent directors instead of requiring that an exchange nominating committee be composed solely of independent directors. A majority of independent directors is the standard that the SEC has used to date with national securities exchanges. We see no reason why a different standard should be used for an exchange that trades security-based swaps.

CBOE and C2 each have a nominating committee that is composed of a majority of public directors. The SEC approved the composition of C2's nominating committee less than a year ago when the SEC approved C2's application to become registered as a national securities exchange and approved the composition of CBOE's nominating committee only a few months ago when the SEC approved CBOE's rule filing related to its demutualization. In both instances, the SEC found that the composition of these nominating committees satisfied the requirements of the Exchange Act. CBOE and C2 have included industry directors on their nominating committees in order to provide for an industry director subcommittee of each nominating committee that is responsible for nominating representative directors. CBOE and C2 each have implemented this structure in order to comply with the requirement under Section 6(b)(3) of the Exchange Act that the rules of an exchange assure a fair representation of its members in the selection of its directors and administration of its affairs. If CBOE or C2 desired to make available for trading security-based swaps, they should not be put in the untenable position of not being able to offer trading in security-based swaps because their existing nominating committees, which were just recently approved by the SEC and are structured to permit CBOE and C2 to comply with the Exchange Act, did not consist solely of independent directors.

Additionally, CBOE believes that industry directors offer valuable insights with respect to qualified candidates for both industry and public director positions. As users of the exchange, they have a unique perspective that public directors do not have and thus an exchange should be permitted to include industry directors on its nominating committee if it chooses to do so.

CBOE also notes that even in the Proposed Requirements there is a recognition that it is appropriate to have a nominating committee composed of a majority of independent directors. Specifically, a security-based swap clearing agency is permitted to have a nominating committee composed of a majority of independent directors under proposed Rule 701(a)(4)(i).

For all of these reasons, CBOE believes that the SEC should permit exchanges to have a majority of independent directors on their nominating committees consistent with the SEC's recent findings in the approvals related to C2 and CBOE that this structure is consistent with the Exchange Act.

An Exchange Should Be Able to Apply Independent Director Qualification Standards Approved by the SEC Through the Rule Filing Process or Exchange Registration Process

To the extent that an exchange that chooses to make available trading in security-based swaps has governing document provisions that have been approved by the SEC through the rule filing process or exchange registration process, or that are approved by the SEC in the future pursuant to the rule filing process, related to qualification to serve as an independent director, the exchange should be able to apply those provisions notwithstanding the independent director qualification standards in proposed Rule 700(j).

In particular, CBOE has in mind provisions like the following that are included in the CBOE and C2 bylaws and were recently approved by the SEC as part of the approvals by the SEC of C2's exchange registration application and CBOE's demutualization rule filing noted above:

[A] director shall not be deemed to be an "Industry Director" solely because either (A) the person is or was within the prior three years an outside director of a broker-dealer or an outside director of an entity that is affiliated with a broker-dealer, provided that the broker-dealer is not a holder of a Trading Permit or otherwise subject to regulation by the

Exchange, or (B) the person is or was within the prior three years associated with an entity that is affiliated with a broker-dealer whose revenues do not account for a material portion of the consolidated revenues of the entities with which the broker-dealer is affiliated, provided that the broker-dealer is not a holder of a Trading Permit or otherwise subject to regulation by the Exchange. At all times, at least one Non-Industry Director shall be a Non-Industry Director exclusive of the exceptions provided for in the immediately preceding sentence and shall have no material business relationship with a broker or dealer or the Exchange or any of its affiliates. For purposes of this [section], the term "outside director" shall mean a director of an entity who is not an employee or officer (or any person occupying a similar status or performing similar functions) of such entity.

These provisions recognize that there are situations in which a person is an outside director of a large entity that has a small broker-dealer affiliate that is not a member of the exchange where the relationship between the person and the broker-dealer is so attenuated and immaterial that the person should not be disqualified from serving as an independent director of the exchange. For example, just because a person is an outside director of a large insurance company or mutual fund company that happens to have a small broker-dealer affiliate among its many affiliated companies which is not a member of the exchange does not mean the person should be conflicted from serving as an independent director of the exchange. Similarly, they also recognize that a person that is an outside director of a broker-dealer or broker-dealer affiliate that is not a member of the exchange does not raise the same types of issues as an affiliation with a member of the exchange since the exchange does not have regulatory authority over the broker-dealer and has no affiliation with the broker-dealer.

These same principles have equal applicability in the context of security-based swaps and with respect to members of exchanges that offer trading in security-based swaps and to SB SEF participants. The best approach would be for the SEC to make clear in the rules that the qualification standards are guidelines only and that the SEC has the ability to allow exchanges have some flexibility in adopting rules under these guidelines. This would be far preferable to exchanges having to seek interpretive guidance or exemptive relief for an exchange governance standard that is somewhat different from a literal reading of the applicable rule but is nonetheless consistent with the intent of the rule.

The SEC Should Clarify that an Independent Director of an Exchange May Serve as a Director of an Exchange Affiliate if the Individual Otherwise Meets the Independent Director Qualification Standards

The SEC should make clear that the independent director qualification standards under proposed Rule 700(j) would not preclude an independent director of an exchange from serving as a director of an affiliate of the exchange if the individual otherwise meets the qualification standards for an independent director. This is an important clarification to exchanges like CBOE and C2 which have non-industry directors that serve on the boards of directors of both exchanges as well as on the board of directors of CBOE's and C2's parent company CBOE Holdings, Inc. ("CBOE Holdings") Such an approach promotes efficiencies and furthers the goal of improving exchange governance in that exchanges like CBOE and C2 should not have to lose the benefit of the wealth of experience and expertise that their non-industry directors bring to their governing boards just because the person also serves the board of a sister exchange or parent company. The SEC has already recognized the benefits of this approach by allowing CBOE and C2 to have the same non-industry directors and allowing those directors to also serve as directors of CBOE Holdings. The Commodity Futures Trading Commission ("CFTC") has also recognized the

benefits of this approach by including a provision to this effect in its proposed governance standards for futures exchanges. (See proposed Regulation 1.3(C)(3) in CFTC Proposed Rulemaking RIN 3038-AD01, 75 FR 63732 (October 18, 2010)).

The Proposed Disqualification for Independent Directors Serving on an Audit Committee Is Ambiguous and Should Be Clarified

Proposed Rule 700(j)(2)(vii) provides that an individual that otherwise qualifies as a independent director is disqualified from serving on an exchange audit committee if the individual accepts, directly or indirectly, any consulting, advisory, or other compensatory fee from the exchange, any affiliate of the exchange, any member of the exchange, or any affiliate of a member of the exchange, subject to two limited exceptions.

CBOE believes that proposed Rule 700(j)(2)(vii) is ambiguous and overly broad. In particular, the inclusion of the direct or indirect acceptance of "any . . . other compensatory fee" as a disqualifying event could potentially be read to include just about any type of payment, no matter how immaterial, remote, and unrelated to the independent director. For example, no regulatory purpose would be served by disqualifying a university professor from serving on an exchange audit committee in the event that a member of the exchange were to attend the university and pay tuition to the university or some other fee to the university such as a fee to park the member's car in the university's parking lot.

Proposed Rule 700(j)(2)(vii) appears to be based upon a similar requirement in Section 10A(m)(3)(B)(i) of the Exchange Act and Exchange Act Rule 10A-3(b)(1)(ii)(A). As it did in adopting Exchange Act Rule 10A-3(B)(1)(ii)(A), the SEC should define in proposed Rule 700(j)(2)(vii) what is meant by indirect acceptance of a fee and the types of compensatory fees that are intended to be covered by the proposed requirement. Among other things, Exchange Act Rule 10A-3 includes paragraph (c)(8) which provides that:

The term *indirect* acceptance by a member of an audit committee of any consulting, advisory or other compensatory fee includes acceptance of such a fee by a spouse, a minor child or stepchild or a child or stepchild sharing a home with the member or by an entity in which such member is a partner, member, an officer such as a managing director occupying a comparable position or executive officer, or occupies a similar position (except limited partners, non-managing members and those occupying similar positions who, in each case, have no active role in providing services to the entity) and which provides accounting, consulting, legal, investment banking or financial advisory services to the issuer or any subsidiary of the issuer.

The SEC should also clarify that an exchange trading a security-based swap is not required to have an audit committee, consistent with what the SEC has already approved for various exchanges. Specifically, an exchange should not be required to have its own audit committee as long as the parent company of an exchange has an audit committee that performs the audit functions for the affiliated group of companies of which the exchange is a part and the exchange's regulatory oversight committee (or another body composed entirely of independent directors) is able to request at any time that the internal auditor of the exchange conduct an audit relating to the regulatory functions of the exchange and reviews all internal audits relating to those functions.

Additionally, the carve-out in proposed Rule 700(j)(2)(vii) for payments received in the capacity of a committee member or director of the exchange should be extended to payments

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received as a committee member or director of the exchange's affiliates consistent with CBOE's comment above that an independent director of an exchange should be able to serve as a director of an exchange affiliate if the individual otherwise meets the qualification standards for an independent director.

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CBOE is available to provide any further input desired by the SEC regarding these issues and to work cooperatively with the SEC to address them. Please contact Joanne Moffic-Silver, General Counsel, at (312) 786-7462, or me, at (312) 786-7570, if you have any questions regarding our comments.

Very truly yours,

A handwritten signature in blue ink that reads "Arthur B. Reinstein". The signature is written in a cursive style with a large initial 'A'.

Arthur B. Reinstein
Deputy General Counsel