

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-62158; File No. SR-CBOE-2008-88)

May 24, 2010

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change as Modified by Amendment No. 1 Relating to the Demutualization of Chicago Board Options Exchange, Incorporated

**I. Introduction**

On August 21, 2008, 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> the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change in connection with its plan to demutualize and restructure from a Delaware non-stock corporation to a Delaware stock corporation that would be a wholly-owned subsidiary of CBOE Holdings, Inc. (“CBOE Holdings”), a holding company organized as a Delaware stock corporation (the “Restructuring Transaction”).<sup>3</sup> To accommodate the Restructuring Transaction, CBOE proposed a Certificate of Incorporation and Bylaws for the newly formed CBOE Holdings, a new Certificate of Incorporation for CBOE, and to replace CBOE’s existing Constitution with new Bylaws. Finally, CBOE proposed amendments to its rules to address, among other things, trading access to the Exchange after the Restructuring Transaction. The proposed rule change was published for comment in the Federal Register on September 4, 2008.<sup>4</sup> The Commission received no comments on the proposal. On May 21, 2010, the Exchange filed

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

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

<sup>3</sup> The term “Restructuring Transaction” is defined in proposed CBOE Rule 1.1(hhh) as “the restructuring of the Exchange from a non-stock corporation to a stock corporation and wholly-owned subsidiary of CBOE Holdings, Inc.”

<sup>4</sup> See Securities Exchange Act Release No. 58425 (August 26, 2008), 73 FR 51652 (“Notice”).

Amendment No. 1 to the proposal.<sup>5</sup> This order provides notice of filing of Amendment No. 1 and grants accelerated approval to the proposed rule change, as modified by Amendment No. 1.

## **II. Discussion and Commission Findings**

After careful review of the proposal, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>6</sup> In particular, as discussed in more detail below, the Commission finds that the proposed rule change is consistent with Section 6(b) of the Act.<sup>7</sup>

### **A. The Restructuring Transaction**

#### **(1) Overview of the Proposed Corporate Structure**

CBOE proposes to restructure from a Delaware non-stock corporation owned by its members to a Delaware stock corporation that would be a wholly-owned subsidiary of CBOE Holdings, a holding company organized as a Delaware stock corporation. As a result of the Restructuring Transaction, CBOE Holdings would become the sole stockholder of CBOE.<sup>8</sup> In

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<sup>5</sup> The substance of the proposed rule change and its filing with the Commission were approved by the Board of Directors of the Exchange prior to filing. At that time, the Exchange had not yet obtained approval from its members for the changes set forth in the proposal. On May 21, 2010, the Exchange obtained the requisite approval from its members. Amendment No. 1, among other things, reflects the membership's approval of this proposed rule change. See infra notes and text following note 172 for a discussion of Amendment No. 1 in greater detail.

<sup>6</sup> In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f.

<sup>8</sup> In Amendment No. 1, CBOE revised the proposed CBOE Holdings' Certificate of Incorporation to include the term "Regulated Securities Exchange Subsidiary" in the places that had referenced CBOE. A "Regulated Securities Exchange Subsidiary" is defined as "any national securities exchange, controlled, directly or indirectly, by CBOE Holdings, including, but not limited to CBOE." This change in terminology addresses CBOE's other national securities exchange C2 Options Exchange, Incorporated and would accommodate ownership of more than one national securities exchange by CBOE Holdings. See Amendment No. 1 at 4. See also Securities

addition, CBOE would transfer to CBOE Holdings all of the shares or interests CBOE currently owns in its subsidiaries, other than CBOE Stock Exchange, LLC, (“CBSX”), thereby making them wholly-owned subsidiaries of CBOE Holdings.<sup>9</sup> CBSX, which is an equity trading facility of CBOE, would remain a facility of CBOE in which CBOE would continue to hold a 50% interest.<sup>10</sup> CBOE would continue to be a self-regulatory organization (“SRO”) and to operate its exchange business and facilities.

CBOE has proposed a new Certificate of Incorporation and Bylaws that are similar to the CBOE’s current Certificate of Incorporation and Constitution, except that they reflect CBOE’s proposed new structure. CBOE also has proposed to adopt a Certificate of Incorporation and Bylaws for CBOE Holdings that would address, among other things, the operation of the Exchange as an SRO in a holding company structure.<sup>11</sup> Finally, CBOE has proposed amendments to certain rules of the Exchange to reflect, among other things, the use of Trading Permits<sup>12</sup> to access the Exchange and its facilities.

(2) Conversion of Memberships

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Exchange Act Release No. 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) (order approving application of C2 Options Exchange, Incorporated).

<sup>9</sup> These subsidiaries are: CBOE Futures Exchange, LLC, which operates an electronic futures exchange; Chicago Options Exchange Building Corporation, which owns the building in which CBOE operates; CBOE, LLC, which holds a 24.01% interest in OneChicago, LLC, a security futures exchange; CBOE II, LLC, which has no assets or activities; DerivaTech Corporation, which owns certain educational software; Market Data Express, LLC, which distributes various types of market data; and The Options Exchange, Incorporated, which currently has no assets or activities.

<sup>10</sup> The remaining 50% interest in CBSX currently is owned by five registered broker-dealers.

<sup>11</sup> See infra note 51 and accompanying text (discussing CBOE’s role in considering amendments to CBOE Holdings’ corporate documents).

<sup>12</sup> See infra note 118 and accompanying text (describing Trading Permits).

After the Restructuring Transaction, the owners of membership interests in CBOE would become stockholders of CBOE Holdings through the conversion of their memberships into shares of common stock of CBOE Holdings. Each transferable CBOE membership existing on the date of the Restructuring Transaction would be converted into a certain number of shares of Class A common stock of CBOE Holdings.<sup>13</sup> The Class A common stock of CBOE Holdings would represent an equity ownership interest in CBOE Holdings, but would not provide its holders with physical or electronic access to CBOE and its trading facilities. In addition, Class B common stock of CBOE Holdings would be issued in the Restructuring Transaction in connection with the settlement of the litigation relating to the exercise right.

**B. CBOE Holdings**

After the Restructuring Transaction, CBOE Holdings would become the parent company and sole shareholder of CBOE. The proposed Certificate of Incorporation and Bylaws of CBOE Holdings would govern the activities of CBOE Holdings.

(1) Governing Structure

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<sup>13</sup> See Amendment No. 1 at 3. In the event of a future public offering by CBOE Holdings, each outstanding share of Class A common stock would be converted to one-half of one share of Class A-1 common stock and one-half share of one share of Class A-2 common stock, each of which would be subject to certain transfer restrictions. Specifically, Class A-1 common stock resulting from a conversion at the time of a public offering would be subject to a 180-day transfer restriction following the offering and Class A-2 common stock would be subject to a 360-day transfer restriction. Upon expiration of the restrictions, Class A-1 and Class A-2 common stock would convert to unrestricted common stock of CBOE Holdings. See *id.* Similarly, the Class B common stock of CBOE Holdings that will be issued in the Restructuring Transaction in connection with the settlement of the litigation relating to the exercise right would also be issued in a single class designated as Class B common stock. To ensure compliance with the transfer restrictions, Class A, Class A-1, Class A-2 and Class B common stock may only be recorded on the books and records of CBOE Holdings in the name of the owner of the shares. See *id.* CBOE Holdings would have the ability to issue preferred stock and unrestricted common stock including in connection with a public offering of shares of stock to investors who were not members of CBOE prior to the Restructuring Transaction and who would not be Trading Permit holders following the Restructuring Transaction. According to the Exchange, CBOE Holdings has no current intention to issue any shares of its preferred stock. See *id.*

CBOE Holdings Board of Directors. The CBOE Holdings Board of Directors (“CBOE Holdings Board”) would be composed of between 11 and 23 directors. Except with respect to the initial CBOE Holdings Board, the exact number would be established by the CBOE Holdings Board.<sup>14</sup> The initial CBOE Holdings Board would be composed of the 22 directors of CBOE immediately prior to the Restructuring Transaction.<sup>15</sup>

Except with respect to the initial CBOE Holdings Board, the Nominating and Governance Committee<sup>16</sup> would nominate candidates for the CBOE Holdings Board.<sup>17</sup> Each holder of CBOE Holdings voting stock would be entitled to one vote for each share of voting stock held, except as otherwise provided by the General Corporation Law of the State of Delaware or the Certificate of Incorporation or Bylaws of CBOE Holdings.<sup>18</sup>

The CBOE Holdings Board would be subject to a heightened independence requirement, with at least two-thirds of the directors satisfying the independence requirements adopted by the CBOE Holdings Board, as may be amended from time to time, which shall satisfy the independence requirements in the listing standards of the New York Stock Exchange (“NYSE”)

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<sup>14</sup> See proposed Article Seventh(b) of the CBOE Holdings Certificate of Incorporation and proposed Article 3.2 of the CBOE Holdings Bylaws.

<sup>15</sup> See Amendment No. 1 at 5-6 (concerning the size of the initial CBOE Holdings Board). CBOE currently has a 23-person Board with one vacancy that the CBOE Board does not intend to fill prior to the consummation of the Restructuring Transaction.

<sup>16</sup> See “Nominating and Governance Committee,” infra Section II.B.2. (describing composition of Nomination and Governance Committee).

<sup>17</sup> See proposed Article 2.11 of the CBOE Holdings Bylaws. Pursuant to proposed Article 2.11, the CBOE Holdings Board or a committee thereof each year would nominate candidates for the directors standing for election at the CBOE Holdings annual meeting of shareholders. See also Amendment No. 1 at 6-7 (discussing director nominees). In addition, subject to certain conditions, stockholders also have the right under this provision to nominate persons for the CBOE Holdings Board.

<sup>18</sup> See proposed Article 2.8 of the CBOE Holdings Bylaws. The Commission notes that there are no provisions in the proposed CBOE Holdings corporate documents providing for anything other than one vote for each share of voting stock held.

or The Nasdaq Stock Market.<sup>19</sup> CBOE Holdings directors would serve one-year terms.<sup>20</sup>

The CBOE Holdings Board would appoint one of its directors to serve as Chairman,<sup>21</sup> and may also appoint an independent director to serve as Lead Director, who would perform such duties and possess such powers as the CBOE Holdings Board may from time to time prescribe.<sup>22</sup>

Committees of CBOE Holdings. CBOE Holdings would have an Executive Committee, an Audit Committee, a Compensation Committee, a Nominating and Governance Committee, and such other committees that the CBOE Holdings Board establishes.<sup>23</sup> The members of each committee would be selected by the CBOE Holdings Board.

The Executive Committee would have all the powers and authority of the CBOE Holdings Board in the management of the business and affairs of CBOE Holdings, except it would not have the power or authority of the CBOE Holdings Board in reference to, among other things, amending the CBOE Holdings Certificate of Incorporation, adopting an agreement of merger or consolidation, approving the sale, lease or exchange of all or substantially all of the CBOE Holdings' property and assets, or approving the dissolution of CBOE Holdings or a

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<sup>19</sup> See Amendment No. 1 at 6. See proposed Article 3.3 of the CBOE Holdings Bylaws. See also Sections 303A.01 and 303A.02 of the NYSE's Listed Company Manual and Nasdaq Stock Market Rule 5605.

<sup>20</sup> See Amendment No. 1 at 6 (changing term duration from two-years, as initially proposed, to one-year).

<sup>21</sup> See proposed Article 3.6 of the CBOE Holdings Bylaws. The proposed CBOE Holdings Bylaws would not restrict the Chief Executive Officer of CBOE Holdings from serving in this role. See proposed Article 5.1 of the CBOE Holdings Bylaws.

<sup>22</sup> See proposed Article 3.7 of the CBOE Holdings Bylaws.

<sup>23</sup> See proposed Article 4.1 of the CBOE Holdings Bylaws. The CBOE Holdings Board would designate the members of these other committees and may designate a Chairman and a Vice-Chairman of each committee.

revocation of a dissolution.<sup>24</sup> The Executive Committee would include the Chairman of the Board (who would serve as the Chairman of the Executive Committee), the Chief Executive Officer (if a director), the Lead Director, if any, and such directors as the CBOE Holdings Board deems appropriate, provided that Executive Committee must at all times have a majority of independent directors.

The Nominating and Governance Committee would recommend members of CBOE Holdings' Executive, Audit, and Compensation Committees for approval by the CBOE Holdings Board.<sup>25</sup> The Nominating and Governance Committee would consist of at least five directors, all of whom would be Independent Directors.<sup>26</sup>

Officers of CBOE Holdings. CBOE Holdings would have a Chief Executive Officer, a Chief Financial Officer, a President, one or more Vice-Presidents (as determined by the CBOE Holdings Board), a Secretary, a Treasurer, and such other officers as the CBOE Holdings Board may determine, including an Assistant Secretary or Assistant Treasurer.<sup>27</sup> The Chief Executive Officer would have general charge and supervision of the business of CBOE Holdings.<sup>28</sup> Other officers would have the duties or powers or both set out in the CBOE Holdings Bylaws, as well

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<sup>24</sup> See proposed Article 4.2 of the CBOE Holdings Bylaws.

<sup>25</sup> See proposed Articles 4.2, 4.3 and 4.4 of the CBOE Holdings Bylaws.

<sup>26</sup> See Article 4.5 of the CBOE Holdings Bylaws. See also Amendment No. 1 at 6-7 (decreasing the size of the committee from seven to five). With the exception of the initial committee, all committee members would be recommended by the Nominating and Governance Committee for approval by the CBOE Holdings Board. See proposed Article 4.5 of the CBOE Holdings Bylaws. The initial Nominating and Governance Committee after the Restructuring Transaction would be selected by the CBOE Board or a committee thereof, consistent with the committee's composition requirements.

<sup>27</sup> See proposed Article 5.1 of the CBOE Holdings Bylaws.

<sup>28</sup> See proposed Articles 5.1 and 5.2 of the CBOE Holdings Bylaws.

as such other duties or powers or both as the CBOE Holdings Board or the Chief Executive Officer may from time to time prescribe.<sup>29</sup>

The Commission finds that the proposed provisions relating to the CBOE Holding Board are consistent with the Act, particularly Section 6(b)(1), which requires an exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>30</sup> In particular, these provisions will assist the Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Act.

(2) Ownership and Voting Restrictions

The proposed Certificate of Incorporation of CBOE Holdings places certain ownership and voting limits on the holders of CBOE Holdings stock and their Related Persons.<sup>31</sup> These restrictions are intended to address the possibility that a person holding a controlling interest in an entity that owns an SRO could use that interest to affect the SRO's regulatory responsibilities.<sup>32</sup>

Ownership Limitation. No person (either alone or together with its Related Persons) may beneficially own more than 10% of the total outstanding shares of CBOE Holdings stock. In the event of a public offering of common stock, the permissible ownership percentage threshold

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<sup>29</sup> See proposed Articles 5.3, 5.4, 5.5, 5.6 and 5.7 of the CBOE Holdings Bylaws.

<sup>30</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>31</sup> The term "Related Person" is defined in proposed Article Fifth(a)(ix) of the CBOE Holdings Certificate of Incorporation and includes, among other things, persons associated with a Trading Permit Holder.

<sup>32</sup> The Commission notes that CBOE has received a legal opinion that the proposed ownership and voting limitations, as well as the provisions providing for the redemption of shares held by a person (either alone or together with its Related Persons) in excess of the ownership limitation, are valid under Delaware law. See Letter from Richards, Layton & Finger to CBOE Holdings, Inc. dated August 15, 2008.



would increase from 10% to 20%.<sup>33</sup> If a person, either alone or together with its Related Persons, exceeds these thresholds, such person and its Related Persons would be obligated to sell promptly, and CBOE Holdings would be obligated to redeem promptly, the number of shares of stock necessary so that such person, together with its Related Persons, would fall below the applicable threshold.<sup>34</sup>

Voting Limitation. No person (either alone or together with its Related Persons) would be entitled to vote or cause the voting of shares of stock beneficially owned by that person or those Related Persons to the extent that those shares would represent in the aggregate more than 10% of the total number of votes entitled to be cast on any matter. Further, no person (either alone or together with its Related Persons) would be entitled to vote more than 10% of the total number of votes entitled to be cast on any matter by virtue of agreements entered into by that person or those Related Persons with other persons not to vote shares of outstanding stock. In the event a public offering of common stock, these permissible voting percentage thresholds would increase from 10% to 20%.<sup>35</sup> Any attempted votes in the excess of such thresholds would be disregarded.<sup>36</sup>

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<sup>33</sup> See proposed Article Sixth(b) of the CBOE Holdings Certificate of Incorporation.

<sup>34</sup> See proposed Article Sixth(b) of the CBOE Holdings Certificate of Incorporation. CBOE Holdings would redeem such stock at a price equal to the par value of such shares of stock and to the extent that funds are legally available for such redemption. If shares of CBOE Holdings stock beneficially owned by any Person or its Related Persons are held of record by any other Person, this provision would be enforced against such record owner by requiring the redemption of shares of CBOE Holdings stock held by such record owner in a manner that would accomplish the ownership limitation applicable to such Person and its Related Persons. See id.

<sup>35</sup> See proposed Article Sixth(a) of the CBOE Holdings Certificate of Incorporation. The voting limitation does not apply to a solicitation of a revocable proxy by any CBOE Holdings stockholder on behalf of CBOE Holdings or by directors or officers of CBOE Holdings on behalf of CBOE Holdings or to a solicitation of a revocable proxy by a stockholder in accordance with Regulation 14A under the Act. 17 CFR 240.14A. This exception, however, would not apply to a solicitation by a stockholder pursuant to Rule 14a-2(b)(2) under the Act, which permits a

Waiver of Ownership or Voting Limitations. The CBOE Holdings Board may waive the ownership and voting limits and may impose conditions or restrictions by means of a resolution expressly permitting ownership or voting rights in excess of such limits, subject to a determination of the Board that:<sup>37</sup>

- the acquisition would not impair the ability of CBOE to discharge its responsibilities under the Act and the rules and regulations thereunder and is otherwise in the best interests of CBOE Holdings and its stockholders and CBOE;
- the acquisition would not impair the Commission’s ability to enforce the Act;
- neither the person obtaining the waiver nor any of its Related Persons is subject to any statutory disqualification (as defined in Section 3(a)(39) of the Act);<sup>38</sup> and
- for so long as CBOE Holdings directly or indirectly controls CBOE, neither the person obtaining the waiver nor any of its Related Persons is a Trading Permit Holder.<sup>39</sup>

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solicitation made otherwise than on behalf of CBOE Holdings where the total number of persons solicited is not more than 10.

<sup>36</sup> See proposed Article Sixth(a) of the CBOE Holdings Certificate of Incorporation. If and to the extent that shares of CBOE Holdings stock beneficially owned by any person or its Related Persons are held of record by any other person, this provision would be enforced against such record owner by limiting the votes entitled to be cast by such record owner in a manner that would accomplish the voting limitation applicable to such person and its Related Persons.

<sup>37</sup> See proposed Articles Sixth(a) and (b) of the CBOE Holdings Certificate of Incorporation. Any such resolution must be filed with the Commission under Section 19 of the Act prior to becoming effective.

<sup>38</sup> 15 U.S.C. 78c(a)(39).

<sup>39</sup> A “Trading Permit Holder” is defined in Section 1.1(f) of the Bylaws of the Exchange as: any individual, corporation, partnership, limited liability company or other entity authorized by the Rules that holds a Trading Permit. If a Trading Permit Holder is an individual, the Trading Permit Holder may also be referred to an “individual Trading Permit Holder.” If a Trading Permit Holder is not an individual, the Trading Permit Holder may also be referred to as a “TPH organization.” A Trading Permit Holder is a “member” solely for purposes of the Act; however, one’s status as a Trading Permit Holder does not confer on that Person any ownership interest in the Exchange.

The CBOE Holdings Board would have the right to require any person and its Related Persons that the Board reasonably believes to be subject to the voting or ownership restrictions summarized above to provide to CBOE Holdings complete information on all shares of CBOE Holdings stock that such stockholder beneficially owns, as well as any other information relating to the applicability to such stockholder of the voting and ownership requirements outlined above as may reasonably be requested.<sup>40</sup>

In addition, any changes to the CBOE Holdings Certificate of Incorporation, including any change in the provision that identifies CBOE Holdings as the sole owner of CBOE, must be filed with and approved by the Commission pursuant to Section 19 of the Act before it could become effective.<sup>41</sup> Further, pursuant to the Exchange's proposed Certificate of Incorporation, CBOE Holdings may not sell, transfer, or assign, in whole or in part, its ownership interest in CBOE. Any such purported action would trigger an amendment both to CBOE Holdings' and CBOE's governing documents, which in turn would be subject to consideration by the Commission pursuant to the rule filing procedure under Section 19 of the Act.

The Commission believes that these provisions are consistent with the Act. These requirements are designed to minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or the Exchange to effectively carry out their regulatory oversight under the Act.

Members that trade on an exchange traditionally have had ownership interests in the exchange, particularly at mutually-held entities like CBOE.<sup>42</sup> However, as the Commission has

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<sup>40</sup> See proposed Article Sixth(d) of the CBOE Holdings Certificate of Incorporation.

<sup>41</sup> See 15 U.S.C. 78s.

<sup>42</sup> With the proposed demutualization of CBOE, all registered national securities exchanges will have converted to or been founded as non-mutually held entities.

noted in the past, a member's interest in an exchange or an entity that controls an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.<sup>43</sup> A member that is a controlling shareholder of an exchange, or an entity that controls an exchange, might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions. The proposed ownership and voting limitations for persons with an equity interest in CBOE Holdings are designed to limit a person's ability to obtain and exercise such a controlling influence.

(3) Self-Regulatory Function and Oversight of CBOE

Although CBOE Holdings will not itself carry out regulatory functions, its activities with respect to the operation of CBOE must be consistent with, and not interfere with, the Exchange's self-regulatory obligations. The proposed CBOE Holdings Certificate of Incorporation contains various provisions designed to protect the independence of the self-regulatory function of CBOE, enable the Exchange to operate in a manner that complies with the federal securities laws, including the objectives of Sections 6(b) and 19(g) of the Act, facilitate the ability of the Exchange and the Commission to fulfill their regulatory and oversight obligations under the Act.

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<sup>43</sup> See Securities Exchange Act Release Nos. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) (order approving application of BATS Exchange, Inc. for registration as an SRO); 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving merger of New York Stock Exchange, Inc. and Archipelago, and demutualization of New York Stock Exchange, Inc.); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08); 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73); and 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (SR-BSE-2003-19).

For example, the proposed CBOE Holdings Certificate of Incorporation contains a provision requiring each director of the CBOE Holdings Board to take into consideration the effect that CBOE Holdings' actions would have on CBOE's ability to carry out its responsibilities under the Act.<sup>44</sup> Similarly, for so long as CBOE Holdings controls CBOE, each officer, director, and employee of CBOE Holdings must give due regard to the preservation of the independence of the self-regulatory function of CBOE and to its obligations under the Act and such persons 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 CBOE ("CBOE Board") relating to CBOE's regulatory functions, including disciplinary matters, or would adversely affect CBOE's ability to carry out its responsibilities under the Act.<sup>45</sup>

Further, the proposed CBOE Holdings Certificate of Incorporation provides that CBOE Holdings, its directors, officers, agents, and employees irrevocably submit to the jurisdiction of the U.S. federal courts, the Commission, and CBOE and CBOE Holdings, its directors, officers, agents, and employees, would waive any claims or defenses that they are not personally subject to the jurisdiction of the Commission, as well as any defenses relating to inconvenient forum, improper venue, or jurisdiction.<sup>46</sup> Further, so long as CBOE Holdings controls CBOE, the books, records, premises, officers, directors, and employees of CBOE Holdings would be deemed to be the books, records, premises, officers, directors, and employees of CBOE for purposes of and subject to oversight pursuant to the Act to the extent that they relate to CBOE.<sup>47</sup>

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<sup>44</sup> See proposed Article Sixteenth(d) of the CBOE Holdings Certificate of Incorporation.

<sup>45</sup> See proposed Article Sixteenth(c) of the CBOE Holdings Certificate of Incorporation.

<sup>46</sup> See proposed Article Fourteenth of the CBOE Holdings Certificate of Incorporation.

<sup>47</sup> The books and records of CBOE Holdings relating to the exchange business of CBOE would be subject at all times to inspection and copying by the Commission and CBOE. See id. In addition,

In addition, all confidential information pertaining to the self-regulatory function of CBOE (including but not limited to disciplinary matters, trading data, trading practices, and audit information) contained in the books and records of CBOE that comes into the possession of CBOE Holdings: (1) could not be made available to any persons other than to those officers, directors, employees and agents of CBOE Holdings that have a reasonable need to know the contents thereof; (2) would be retained in confidence by CBOE Holdings and the officers, directors, employees and agents of CBOE Holdings; and (3) could not be used for any commercial purposes.<sup>48</sup>

The proposed CBOE Holdings Certificate of Incorporation also requires CBOE Holdings to take reasonable steps to cause its directors, officers, and employees, prior to accepting such position with CBOE Holdings, to consent in writing to the applicability to them of Article Fourteenth, Article Fifteenth, and Sections (c) and (d) of Article Sixteenth of the CBOE Holdings Certificate of Incorporation, as applicable, with respect to their activities related to CBOE.<sup>49</sup> In addition, CBOE Holdings would take reasonable steps necessary to cause its agents, prior to accepting such a position with CBOE Holdings, to be subject to the same provisions, as applicable, with respect to their activities related to CBOE.<sup>50</sup>

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the CBOE Holdings Bylaws provide that the books of CBOE Holdings must be kept within the United States. See proposed Section 1.3 of the CBOE Holdings Bylaws.

<sup>48</sup> Notwithstanding this restriction, nothing in the CBOE Holdings Certificate of Incorporation would be interpreted so as to limit or impede the rights of the Commission or CBOE to access and examine such confidential information or to limit or impede the ability of any officers, directors, employees or agents of CBOE Holdings to disclose such confidential information to the Commission or CBOE. See proposed Article Fifteenth of the CBOE Holdings Certificate of Incorporation.

<sup>49</sup> See proposed Article Sixteenth(b) of the CBOE Holdings Certificate of Incorporation.

<sup>50</sup> See id.

In addition, for so long as CBOE Holdings controls CBOE, CBOE Holdings would be required to submit to the CBOE Board any proposed amendment to or repeal of any provision of the CBOE Holdings Certificate of Incorporation or CBOE Holdings Bylaws and to file such with the Commission before it may become effective.<sup>51</sup>

The Commission finds that the proposed governing documents for CBOE Holdings, discussed above, are designed to protect the independence of the self-regulatory function of CBOE and clarify the Commission's and CBOE's jurisdiction with respect to CBOE Holdings in a manner consistent with the Act. Accordingly, these provisions should help ensure CBOE Holdings' attention to the self-regulatory obligations of CBOE and facilitate the ability of CBOE to effectively carry out its regulatory responsibilities under the Act.

The Commission notes that under Section 20(a) of the Act,<sup>52</sup> any person with a controlling interest in CBOE would be jointly and severally liable with and to the same extent that CBOE is liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Act,<sup>53</sup> creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of any provision of the Act or rule thereunder. Further, Section 21C of the Act<sup>54</sup> authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Act through an act or omission that the person knew or should

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<sup>51</sup> See proposed Article Eleventh of the CBOE Holdings Certificate of Incorporation and proposed Article 10.2 of the CBOE Holdings Bylaws.

<sup>52</sup> 15 U.S.C. 78t(a).

<sup>53</sup> 15 U.S.C. 78t(e).

<sup>54</sup> 15 U.S.C. 78u-3.

have known would contribute to the violation. These provisions are applicable to CBOE Holdings' dealings with CBOE.

### C. CBOE

Following the Restructuring Transaction, CBOE would become a Delaware for-profit stock corporation wholly-owned by CBOE Holdings. CBOE would issue a total of 1,000 shares of common stock, all of which would be owned by CBOE Holdings.<sup>55</sup> CBOE would continue to be registered as a national securities exchange under Section 6 of the Act and, accordingly, would continue to be an SRO responsible for enforcing compliance by its members (i.e., Trading Permit Holders) with the federal securities laws and with CBOE Rules.<sup>56</sup> Likewise, CBOE would continue as a participant and voting member in the following national market system plans: the Options Price Reporting Authority Plan, the Consolidated Tape Association, the Consolidated Quotation Plan, the Nasdaq Unlisted Trading Privileges Plan, the Options Order Protection and Locked/Crossed Market Plan, the Options Regulatory Surveillance Authority Plan, and the Options Listing Procedures Plan.<sup>57</sup>

CBOE's current Certificate of Incorporation, Constitution (which would be replaced by the proposed Bylaws), and selected rules are proposed to be amended to reflect, among other things, CBOE's status as wholly-owned subsidiary of CBOE Holdings.

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<sup>55</sup> Any sale, transfer or assignment by CBOE Holdings of any shares of CBOE common stock would require an amendment to the proposed CBOE Certificate of Incorporation and consequently would be subject to prior approval by the Commission pursuant to the rule filing procedure under Section 19 of the Act (15 U.S.C. 78s). See proposed Article Fourth of the CBOE Certificate of Incorporation.

<sup>56</sup> 15 U.S.C. 78f.

<sup>57</sup> These plans are joint industry plans entered into by SROs for the purpose of providing for, respectively, (i) last sale and quotation reporting in options and equities, (ii) intermarket options trading, (iii) the joint surveillance, investigation and detection of insider trading on the options exchanges, and (iv) the listing of standardized options.



(1) CBOE Board and Committees

The business and affairs of CBOE would continue to be managed under the direction of the CBOE Board. The CBOE Board would be composed of between 11 and 23 directors as fixed by the CBOE Board from time to time.<sup>58</sup> The initial CBOE Board would be composed of the 22 individuals who are the directors of CBOE immediately prior to the Restructuring Transaction.<sup>59</sup> Thus, the CBOE Board following the Restructuring Transaction would be composed of CBOE's Chief Executive Officer, twelve Non-Industry<sup>60</sup> Directors, and ten Industry<sup>61</sup> Directors.<sup>62</sup>

The number of Non-Industry Directors and Industry Directors may be increased from time to time by resolution of the CBOE Board, but the number of Industry Directors could not constitute less than 30% of the CBOE Board and in no event would the number of Non-Industry Directors constitute less than a majority of the CBOE Board.<sup>63</sup> In addition, at least 20% of the directors must be Industry Directors nominated (or otherwise selected through the petition process) by the Industry-Director Subcommittee (directors selected through this process are

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<sup>58</sup> See Amendment No. 1 at 7. See also proposed Article Fifth(b) of the CBOE Certificate of Incorporation and proposed Section 3.1 of the CBOE Bylaws.

<sup>59</sup> See Amendment No. 1 at 7.

<sup>60</sup> A "Non-Industry Director" would be defined as a person who is not an Industry Director. See proposed Section 3.1 of the CBOE Bylaws.

<sup>61</sup> See Notice, supra 4, 73 FR at 51658, n.58.

<sup>62</sup> See proposed Article Fifth(b) of the Amended and Restated Certificate of Incorporation and proposed Section 3.1 of the CBOE Bylaws. In comparison, the current CBOE Board has 23 directors, consisting of eleven public directors, eleven directors from the industry, and the Chairman of the Board (who is the CEO of CBOE). See Notice, supra note 4, 73 FR at 51658 (discussing the composition of the current CBOE Board).

<sup>63</sup> At all times, at least one Non-Industry Director would be a Non-Industry Director exclusive of the exceptions provided for in proposed Section 3.1 of the CBOE Bylaws and would have no material business relationship with a broker or dealer or the Exchange or any of its affiliates. See proposed Section 3.1 of the CBOE Bylaws.

referred to as “Representative Directors”).<sup>64</sup> Directors would serve for one-year terms ending on the annual meeting following the meeting at which such directors were elected.<sup>65</sup>

The CBOE Board would appoint one of its directors to serve as Chairman, which could be the Chief Executive Officer of CBOE.<sup>66</sup> Each year following the annual election of the directors, the CBOE Board would select, from among the Industry Directors, a Vice Chairman of the CBOE Board to serve for a term of one year.<sup>67</sup> The CBOE Board also may appoint one of the Non-Industry Directors to serve as Lead Director, who would perform such duties and possess such powers as the CBOE Board may from time to time prescribe.<sup>68</sup>

(2) Nomination and Election of Directors

Qualified individuals would be nominated for election to the CBOE Board by CBOE’s Nominating and Governance Committee.<sup>69</sup> The committee would consist of at least seven

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<sup>64</sup> See proposed Section 3.1 of the CBOE Bylaws.

<sup>65</sup> See Amendment No. 1 at 9-10.

<sup>66</sup> See proposed Section 3.6 of the CBOE Bylaws. See also proposed Section 5.1(a) of the CBOE Bylaws (concerning the ability of the CEO to serve as Chairman of the CBOE Board).

<sup>67</sup> See proposed Section 3.7 of the CBOE Bylaws. The Vice Chairman would: (i) preside over the meetings of the CBOE Board in the event the Chairman of the Board is absent or unable to do so, (ii) serve as chair the Trading Advisory Committee, (iii) except as otherwise provided in the Rules or resolution of the CBOE Board, appoint, subject to the approval of the CBOE Board, the individuals to serve on all Trading Permit Holder committees established in the Rules or by resolution of the Board, and (iv) exercise such other powers and perform such other duties as are delegated to the Vice Chairman of the Board by the CBOE Board.

<sup>68</sup> See proposed Section 3.8 of the CBOE Bylaws. The CBOE Board currently has a Lead Director, and as provided in proposed Section 3.8 of the CBOE Bylaws, CBOE has the ability to continue the practice after the Restructuring Transaction.

<sup>69</sup> See *id.* In performing this function, the Nominating and Governance Committee would determine, subject to review by the Board, whether a director candidate satisfies the applicable qualifications for election as a director, and the decision of that committee shall, subject to review, if any, by the Board, be final. See proposed Section 3.1 of the CBOE Bylaws. CBOE anticipates that the Nominating and Governance Committee would use director questionnaires in connection with determining the qualifications of director candidates. See Notice, *supra* note 4, 73 FR at 51659, n.74.

directors, with a majority being Non-Industry Directors,<sup>70</sup> all of whom would be recommended by the then-serving Nominating and Governance Committee for approval by the Board. The initial Nominating and Governance Committee after the Restructuring Transaction would be selected by the CBOE Board or a committee thereof, consistent with the applicable proposed compositional requirements.<sup>71</sup>

Industry-Director Subcommittee. The Industry-Director Subcommittee of the Nominating and Governance Committee, composed of all of the Industry Directors then serving on the Nominating and Governance Committee, would be responsible for recommending a number of Representative Directors that equals 20% of the total number of directors serving on the CBOE Board.<sup>72</sup> The subcommittee would provide a mechanism for Trading Permits Holders to provide input with respect to nominees for the Representative Directors. The subcommittee would also issue a circular to Trading Permit Holders identifying the Representative Director nominees.<sup>73</sup>

The proposed Nominating and Governance Committee would be bound to accept and nominate the Representative Directors recommended by the Industry-Director Subcommittee, provided that the Representative Directors so nominated by the Industry-Director Subcommittee

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<sup>70</sup> See proposed Section 4.5 of the CBOE Bylaws.

<sup>71</sup> The composition of the proposed new Nominating and Governance Committee differs from the composition of CBOE's current Nominating Committee in that the current Nominating Committee consists of a majority of "industry" members and is not tasked with responsibility for governance issues. In addition, the current Nominating Committee is not a committee of the current CBOE Board, but rather is a separate committee elected by the voting members of the Exchange. See Section 4.1 of the current CBOE Constitution.

<sup>72</sup> See proposed Section 3.2 of the CBOE Bylaws. If 20% of the directors then serving on the CBOE Board is not a whole number, such number of Representative Directors would be rounded up to the next whole number. See proposed Section 3.2 of the CBOE Bylaws. Industry Directors not selected by the Industry-Director Subcommittee would be selected by the Nominating and Governance Committee. See proposed Section 3.2 of the CBOE Bylaws.

<sup>73</sup> See id.

are not opposed by a petition candidate. If such Representative Directors are opposed by a petition candidate, then the Nominating and Governance Committee would be bound to accept and nominate the Representative Directors who receive the most votes pursuant to a “Run-off Election,” as described below.<sup>74</sup>

Petition Process. Trading Permit Holders may nominate alternative candidates for election to the Representative Director positions by submitting a petition signed by individuals representing not less than 10% of the total outstanding Trading Permits at that time. If one or more valid petitions are received, a Run-off Election would be held. In any Run-off Election, each Trading Permit Holder would have one vote for each Representative Director position; provided, however, that no Trading Permit Holder, either alone or together with its affiliates, may account for more than 20% of the votes cast for a candidate. Any votes cast by a Trading Permit Holder, either alone or together with its affiliates, in excess of this 20% limitation would be disregarded.<sup>75</sup>

The winner(s) of the Run-off Election would be nominated as the Representative Director(s) by the Nominating and Governance Committee for that year. In addition, CBOE and CBOE Holdings have entered into a Voting Agreement pursuant to which CBOE Holdings has committed to vote in favor of the Representative Directors recommended by the Nominating and Governance Committee.<sup>76</sup>

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<sup>74</sup> See id.

<sup>75</sup> See proposed Section 3.1 of the CBOE Bylaws. In any Run-off Election, Trading Permits representing one-third of the total outstanding Trading Permits entitled to vote, when present in person or represented by proxy, would constitute a quorum for purposes of the Run-off Election. See id.

<sup>76</sup> CBOE included the proposed Voting Agreement as Exhibit 5F to its proposed rule change.

The Commission believes that the requirements in the proposed CBOE Bylaws that 20% of the CBOE Board be Representative Directors and the means by which they are chosen by members provides for the fair representation of members in the selection of directors and the administration of the Exchange consistent with the requirements of Section 6(b)(3) of the Act.<sup>77</sup> As the Commission has previously noted, this requirement helps to ensure that members have a voice in the use of the SRO's self-regulatory authority, and that an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.<sup>78</sup>

The Commission has previously stated its belief that the inclusion of public, non-industry representatives on exchange oversight bodies is critical to an exchange's ability to protect the public interest.<sup>79</sup> Further, public non-industry representatives help to ensure that no single group of market participants has the ability to disadvantage other market participants through the exchange governance process. The Commission believes that public directors can provide unique, unbiased perspectives, which should enhance the ability of the CBOE Board to address issues in a non-discriminatory fashion and foster the integrity of the Exchange.<sup>80</sup> The Commission also believes that the proposed CBOE Board satisfies the requirements in Section 6(b)(3) of the Act,<sup>81</sup> which requires that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, or with a broker or dealer. In

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<sup>77</sup> 15 U.S.C. 78f(b)(3).

<sup>78</sup> See, e.g., Securities Exchange Act Release Nos. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) ("BATS Exchange Registration Order"); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131) ("Nasdaq Exchange Registration Order").

<sup>79</sup> See, e.g., Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) ("Regulation ATS Release").

<sup>80</sup> See, e.g., BATS Exchange Registration Order and Nasdaq Exchange Registration Order, supra note 78, 73 FR at 49501 and 71 FR at 3553, respectively.

<sup>81</sup> 15 U.S.C. 78f(b)(3).

particular, at least one Non-Industry Director would be a Non-Industry Director exclusive of any exceptions and would have no material business relationship with a broker or dealer or the Exchange or any of its affiliates.

(3) Committees of CBOE

In addition to the Nominating and Governance Committee discussed above, CBOE would have an Executive Committee, an Audit Committee, a Compensation Committee, a Regulatory Oversight Committee, and such other standing and special committees as may be approved by the CBOE Board. Except as may be otherwise provided in the CBOE Bylaws, the Board would have the authority to remove committee members.<sup>82</sup>

Director Committees. Director candidates for CBOE's Executive, Audit, and Compensation Committees would be recommended by the Nominating and Governance Committee for approval by the CBOE Board.<sup>83</sup> The Audit Committee and the Compensation Committee would each consist of at least three directors, all of whom would be Non-Industry Directors.<sup>84</sup> The Regulatory Oversight Committee, which would be charged with overseeing the independence and integrity of the regulatory functions of the Exchange, would consist of at least three directors,<sup>85</sup> all of whom would be Non-Industry Directors recommended by the Non-Industry Directors on the Nominating and Governance Committee for approval by the Board.<sup>86</sup>

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<sup>82</sup> See proposed Section 4.1(a) of the CBOE Bylaws.

<sup>83</sup> See proposed Sections 4.2, 4.3 and 4.4 of the CBOE Bylaws. The selection and composition of the Nominating and Governance Committee is discussed above.

<sup>84</sup> See proposed Section 4.3 of the CBOE Bylaws (Audit Committee) and Section 4.4 of the CBOE Bylaws (Compensation Committee).

<sup>85</sup> See Amendment No. 1 at 11 (changing the number of directors required from four to three to allow for greater flexibility in the designation of the committee).

<sup>86</sup> See proposed Section 4.6 of the CBOE Bylaws.

The Executive Committee<sup>87</sup> would consist of the Chairman and Vice Chairman of the CBOE Board, the Chief Executive Officer (if a director), the Lead Director (if any), at least one Representative Director, and such other number of directors that the Board deems appropriate, provided that at all times the majority of the directors serving on the Executive Committee are Non-Industry Directors.<sup>88</sup>

Member Committees. In addition to these CBOE Board-level committees, CBOE would have certain Exchange-level committees, including a Trading Advisory Committee and such other committees as may be provided from time to time.<sup>89</sup> The proposed Trading Advisory Committee would advise the Office of the Chairman regarding matters of interest to Trading

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<sup>87</sup> CBOE noted that its current Executive Committee (as well as the proposed new Executive Committee) generally does not make a decision unless there is a need for a CBOE Board-level decision between CBOE Board meetings due to the time sensitivity of the matter. See Notice, supra note 4, 73 FR at 51660-61. In addition, in situations when the current Executive Committee does make a decision between CBOE Board meetings, CBOE noted that the CBOE Board is generally aware ahead of time of the potential that the Executive Committee may need to make the decision. See id. CBOE notes that the current CBOE Board is, and after the Restructuring Transaction would continue to be, fully informed of any decision made by the current (and new) Executive Committee at its next meeting and can always decide to review that decision and take different action. See id.

<sup>88</sup> See proposed Section 4.2 of the CBOE Bylaws. If the Vice Chairman is a Representative Director, the requirement to have at least one Representative Director on the new Executive Committee would be satisfied by the Vice Chairman's participation on that committee. The Executive Committee would have all the powers and authority of the CBOE Board in the management of the business and affairs of CBOE, except it would not have the power and authority of the Board to, among others: (i) approve or adopt or recommend to the stockholders any action or matter (other than the election or removal of directors) expressly required by Delaware law to be submitted to stockholders for approval, including without limitation, amending the proposed CBOE Certificate of Incorporation, adopting an agreement of merger or consolidation, approving a sale, lease or exchange of all or substantially all of CBOE's property and assets, or approval of a dissolution of CBOE or revocation of a dissolution, or (ii) adopt, alter, amend or repeal any bylaw of CBOE. See proposed Section 4.2 of the CBOE Bylaws.

<sup>89</sup> See proposed Section 4.1(b) of the CBOE Bylaws. "Exchange committees" refers to committees that are not solely composed of directors from the CBOE Board. Except as may be otherwise provided in the CBOE Bylaws, the rules or the resolution of the CBOE Board establishing any such other committee, the Vice Chairman of the Board, with the approval of the CBOE Board, would appoint the members of such Exchange committees (other than the committees of the CBOE Board) and may designate, with the approval of the Board, a Chairman and a Vice-Chairman thereof.

Permit Holders.<sup>90</sup> The majority of the committee would be individuals involved in trading either directly or through their firms. The Vice Chairman would serve as the Chairman of the committee and would appoint, with the approval of the CBOE Board, the other members of the committee. The proposed Trading Advisory Committee would serve as the replacement for CBOE's current Floor Directors Committee, which advises CBOE regarding trading and floor-related issues.

In addition, CBOE would continue to maintain a Business Conduct Committee ("BCC"), which would remain involved with the hearing of disciplinary matters.<sup>91</sup> CBOE is not proposing any material changes to the structure or function of the BCC.<sup>92</sup>

The Commission believes that the compositional requirements with respect to the committees discussed above are designed to ensure that members are protected from unfair, unfettered actions by the Exchange pursuant to its rules, and that, in general, the Exchange is administered in a way that is equitable to all those who trade on its market or through its facilities. The Commission believes that the proposed compositional balance of these CBOE committees is consistent with the Section 6(b)(3) of the Act, because it provides for the fair representation of Trading Permit Holders in the administration of the affairs of CBOE.

(4) Filling of Vacancies and Removal for Cause

Any vacancy in the CBOE Board could be filled by vote of a majority of the directors then in office or by a sole remaining director, provided such new director qualifies for the

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<sup>90</sup> See proposed Section 4.7 of the CBOE Bylaws.

<sup>91</sup> See CBOE Rule 2.1(a). See also *infra* II.D (discussing the BCC).

<sup>92</sup> See Notice, *supra* note 4, 73 FR at 51663.



category in which the vacancy exists.<sup>93</sup> In the event the CBOE Board needs to fill a vacancy in a Representative Director position, the Industry-Director Subcommittee of the Nominating and Governance Committee would either (i) recommend an individual to the CBOE Board to be elected to fill such vacancy or (ii) provide a list of recommended individuals to the CBOE Board from which the Board shall elect the individual to fill such vacancy.<sup>94</sup> In addition, the proposed CBOE Bylaws provide that no Representative Director may be removed from office at any time except for cause.<sup>95</sup>

(5) Officers of CBOE

CBOE would have a Chief Executive Officer, a Vice Chairman, a President, a Chief Financial Officer, one or more Vice-Presidents, a Secretary, a Treasurer, and such other officers as the CBOE Board may determine, including an Assistant Secretary and Assistant Treasurer.<sup>96</sup> In general, the officers would have the duties and powers set forth in the CBOE Bylaws, as well as such other duties or powers or both as the CBOE Board or, as applicable, the Chief Executive Officer may from time to time prescribe.<sup>97</sup>

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<sup>93</sup> See proposed Section 3.5(a) of the CBOE Bylaws.

<sup>94</sup> See proposed Section 3.5(b) of the CBOE Bylaws. Any individual recommended by the Industry-Director Subcommittee to fill the vacancy of a Representative Director position must qualify as an Industry Director.

<sup>95</sup> See proposed Section 3.4(c) of the CBOE Bylaws.

<sup>96</sup> See proposed Section 5.1(a) of the CBOE Bylaws.

<sup>97</sup> See proposed Sections 5.3, 5.4, 5.5, 5.6, 5.7 and 5.8 of the CBOE Bylaws. A few notable differences concerning CBOE's officers following the Restructuring Transaction include the following: (1) the Chief Executive Officer may, but would not have to, be a director or the Chairman of the CBOE Board; (2) the CBOE Board, as opposed to the membership, would select the Vice Chairman; and (3) the position of Chief Financial Officer would be formally incorporated into the CBOE Bylaws.

Contrary to the current CBOE Constitution,<sup>98</sup> the proposed CBOE Bylaws would not restrict an officer from being a Trading Permit Holder or a person associated with a Trading Permit Holder or a broker or a dealer in securities or commodities or an associated person of such broker or dealer. The Exchange notes that there are other protections in place that limit the potential conflicts between the Exchange as an SRO and Trading Permit Holders, including, among other things, the existence of a Regulatory Oversight Committee as a committee of the Board that consists solely of Non-Industry Directors.<sup>99</sup>

The Commission finds that this proposed change consistent with the Act, including Section 6(b)(2) of the Act,<sup>100</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer may become a member. The Commission finds that there are sufficient safeguards in place to limit potential conflicts of interest between the Exchange as an SRO and Trading Permit Holders.

(6) Self-Regulatory Function and Oversight

As noted above, following the Restructuring Transaction, CBOE would continue to be registered as a national securities exchange under Section 6 of the Act and thus would continue to be an SRO.<sup>101</sup> As an SRO, CBOE is obligated to carry out its statutory responsibilities, including enforcing compliance by Trading Permit Holders with the provisions of the federal securities laws and the rules of CBOE. In addition, CBOE would continue to be required to file

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<sup>98</sup> See Section 8.1(b) of the current CBOE Constitution.

<sup>99</sup> See Notice, *supra* note 4, 73 FR at 51662.

<sup>100</sup> 15 U.S.C. 78f(b)(2).

<sup>101</sup> 15 U.S.C. 78f.

with the Commission, pursuant to Section 19(b) of the Act<sup>102</sup> and Rule 19b-4 thereunder,<sup>103</sup> any proposed changes to its rules and governing documents.

The proposed CBOE Certificate of Incorporation contains various provisions designed to protect the self-regulatory functions of CBOE in light of the proposed new corporate structure. For example, each director would be required to take into consideration the effect that his or her actions would have on CBOE's ability to carry out its responsibilities under the Act.<sup>104</sup> The proposed CBOE Certificate of Incorporation also includes provisions designed to protect confidential information pertaining to the self-regulatory function of the Exchange.<sup>105</sup>

In addition, proposed CBOE Rule 2.51 requires that any revenue CBOE receives from regulatory fees or penalties would only be applied to fund the legal, regulatory, and surveillance operations of the Exchange and would not be used to pay dividends to CBOE Holdings, except in the event of liquidation of CBOE, in which case CBOE Holdings would be entitled to the distribution of CBOE's remaining assets.<sup>106</sup>

The Commission believes that the Exchange's proposed provisions concerning the self-regulatory function of CBOE are consistent with the Act, particularly, with Section 6(b)(1), which requires an Exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>107</sup> In particular, CBOE's proposed governing documents are designed to assist the

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<sup>102</sup> 15 U.S.C. 78s(b).

<sup>103</sup> 17 CFR 240.19b-4.

<sup>104</sup> See proposed Article Fifth(d) of the CBOE Certificate of Incorporation.

<sup>105</sup> See proposed Article Eleventh of the CBOE Certificate of Incorporation.

<sup>106</sup> See Notice, supra note 4, 73 FR at 51662, and Amendment No. 1 at 14 (codifying this provision in proposed Rule 2.51).

<sup>107</sup> See 15 U.S.C. 78f(b)(1).

Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Act.

(7) Paragraph (b) of Article Fifth of the CBOE Certificate of Incorporation

While the content of the Exchange's new Certificate of Incorporation and Bylaws would be similar to the content of the Exchange's old Certificate of Incorporation and Constitution, the new Certificate of Incorporation would not include, among other things, paragraph (b) of Article Fifth of the current CBOE Certificate of Incorporation ("Article Fifth(b)").<sup>108</sup> Article Fifth(b) provides the right for full members of The Board of Trade of the City of Chicago, Inc. ("CBOT") to become members of CBOE without having separately to purchase or lease a membership.<sup>109</sup>

Article Fifth(b) further provides that no amendment may be made to it without the prior approval of not less than 80% of both (i) the regular members of the Exchange admitted pursuant to Article Fifth(b) and (ii) the regular members of the Exchange admitted other than pursuant to Article Fifth(b), with each category voting as a separate class. CBOE has received a legal opinion from its Delaware counsel that under Delaware law, because the Restructuring Transaction is structured as a merger, this provision of Article Fifth(b) would not be triggered

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<sup>108</sup> As a result of this change, the Exchange is proposing to delete CBOE Rule 3.16, which addresses certain issues related to Article Fifth(b).

<sup>109</sup> On January 15, 2008, the Commission approved an interpretation of Article Fifth(b) ("Article Fifth(b) Interpretation") that addressed the impact of the acquisition of CBOT by Chicago Mercantile Exchange Holdings Inc. ("CME/CBOT Transaction") on the eligibility of persons to become or remain members of CBOE ("exerciser members") pursuant to Article Fifth(b) (the right provided under this provision is sometimes referred to as the "exercise right"). See Securities Exchange Act Release No. 57159 (January 15, 2008), 73 FR 3769 (January 22, 2008) (order approving File No. SR-CBOE-2006-106). Under that interpretation, the consummation of the CME/CBOT Transaction resulted in no person any longer qualifying as a member of the CBOT within the meaning of Article Fifth(b) and therefore resulted in the elimination of any person's eligibility to qualify thereafter to become or remain an exerciser member of the Exchange.

and the demutualization and related amendments to the Exchange's governing documents could be effected through a simple majority vote of members.<sup>110</sup>

In approving this proposal, the Commission is relying on CBOE's representation that its approach is appropriate under Delaware state law. The Commission is also relying on CBOE's letter of counsel that concludes that the Restructuring Transaction constitutes a merger and thus does not require the 80% vote contemplated in Article Fifth(b). Without opining on the merits of any claims arising solely under state law, the Commission finds that CBOE has articulated a sufficient basis to support its proposed changes.

**D. Disciplinary Matters and Trading and Disciplinary Rule Changes**

An exchange must be organized and have the capacity to carry out the purposes of the Act. Specifically, an exchange must be able to enforce compliance by its members and persons associated with its members with federal securities laws and the rules of the exchange.<sup>111</sup>

CBOE's current process for the hearing of disciplinary matters, and the rules governing that process, would remain substantively unchanged after the Restructuring Transaction. Under CBOE Rule 17.6(a), the hearing of a disciplinary matter currently is conducted by one or more members of the BCC. It has been the BCC's general practice to use three-person BCC hearing panels that include both industry and public representation, and CBOE is not proposing to change this process following demutualization.<sup>112</sup> Consistent with CBOE Rule 17.9, any decision of a BCC hearing panel that is not composed of at least a majority of the BCC is reviewed by the full BCC.

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<sup>110</sup> See Letter from Richards, Layton & Finger to Chicago Board Options Exchange, Incorporated dated August 20, 2008.

<sup>111</sup> See 15 U.S.C.78f(b)(1).

<sup>112</sup> See Notice, supra note 4, 73 FR at 51661.

In addition, the current process for the review of appeals of disciplinary actions, and the rules governing that process, would remain substantively unchanged. Under current Rule 17.10(b), the CBOE Board is vested with the authority to review appeals of disciplinary actions. The CBOE Board may appoint a committee of the Board composed of at least 3 directors to review the appeal, but the decision of that committee must be ratified by the CBOE Board. Thus, after the Restructuring Transaction, Trading Permit Holders would have a say in the review of such appeals through their representation on the CBOE Board.<sup>113</sup>

The current process for the review of proposed trading and disciplinary rules also would remain unchanged. Since the CBOE Board would continue to be responsible for approving rule changes, including changes to trading and disciplinary rules,<sup>114</sup> Trading Permit Holders would have a voice in the review of these rules through their representation on the CBOE Board. In addition, the proposed Trading Advisory Committee, which would replace the existing Floor Directors Committee, would assume that prior committee's responsibility for the review of many of CBOE's proposed rule changes (particularly trading rules) in an advisory capacity. Accordingly, the Trading Advisory Committee would provide a mechanism for Trading Permit Holders to provide input on trading rules.

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<sup>113</sup> As CBOE previously noted, it has been the CBOE Board's general practice to appoint a cross-section of directors to the CBOE Board committees that review appeals of disciplinary actions. See Notice, supra note 4, 73 FR at 51662. These committees usually consist of a floor or at-large director, an off-floor director, and a public director. See id. CBOE is not proposing to change this general practice and would expect that CBOE Board committees that review disciplinary decision appeals after the Restructuring Transaction would generally consist of an Industry Director who or whose firm is engaged in trading on the Exchange, an Industry Director whose firm is significantly engaged in conducting a securities business with public customers, and a Non-Industry Director. See id.

<sup>114</sup> See proposed Section 10.1 of the CBOE Bylaws.

The Commission finds that the Exchange’s amended By-Laws and rules concerning its disciplinary and oversight programs are consistent with the Act, including the requirements of Sections 6(b)(6)<sup>115</sup> of the Act, which requires the rules of an exchange to provide for the appropriate discipline of its members and persons associated with members for violations of the federal securities laws and exchange rules, and Section 6(b)(7),<sup>116</sup> which requires the rules of an exchange to provide a fair procedure for the disciplining of members and persons associated with members, in that they are designed to provide fair procedures for the disciplining of members and persons associated with members. The Commission further finds that the proposal is designed to provide the Exchange with the ability to comply, and with the authority to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of Exchange.<sup>117</sup>

**E. Trading Permits**

Prior to the Restructuring Transaction, Exchange memberships provided trading access to the Exchange. After the Restructuring Transaction, “Trading Permits” would provide trading access to the Exchange.<sup>118</sup> A person or entity that holds a Trading Permit would be referred to as

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<sup>115</sup> 15 U.S.C. 78f(b)(6).

<sup>116</sup> 15 U.S.C. 78f(b)(7).

<sup>117</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>118</sup> See proposed CBOE Rule 1.1(ggg) (defining Trading Permit). “Trading Permits” would be defined as licenses issued by the Exchange that grant the holders or the holders’ nominee the right to access the Exchange or one or more of its facilities for the purpose of effecting transactions in securities traded on the Exchange without the services of another person acting as broker, and otherwise to access the Exchange or its facilities for purposes of trading or reporting transactions or transmitting orders or quotations in securities traded on the Exchange, or to engage in other activities that, under CBOE rules, may only be engaged in by holders of Trading Permits, provided that the holder or the holder’s nominee, as applicable, satisfies any applicable qualification requirements to exercise those rights.

a “Trading Permit Holder.”<sup>119</sup> Trading Permit Holders would meet the definition of “member” in Section 3(a)(3)(A) of the Act.<sup>120</sup> As members under the Act, Trading Permit Holders and their nominees would be subject to the regulatory jurisdiction of the Exchange, including the Exchange’s disciplinary jurisdiction under Chapter XVII of the CBOE Rules.<sup>121</sup>

A Trading Permit would not convey any ownership interest in the Exchange, would only be available through the Exchange, and would be subject to the terms and conditions set forth in proposed CBOE Rule 3.1. As a result of the Exchange’s proposed new structure in which ownership would be separated from trading access, the Exchange is planning to propose separately to replace the term “member” throughout its rules with the term “Trading Permit Holder.”<sup>122</sup>

(1) Features of Trading Permits

The Exchange would have the authority to issue different types of Trading Permits that allow holders thereof to trade one or more products authorized for trading on the Exchange and to act in one or more authorized trading functions. Trading Permits would be for set terms specified by the Exchange.<sup>123</sup> The Exchange expects initially to offer Trading Permits for terms

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<sup>119</sup> See proposed Section 1.1(f) of the CBOE Bylaws (defining Trading Permit Holder) and proposed CBOE Rule 1.1(gg) (defining Trading Permit Holder). A “Trading Permit Holder” could be an individual, corporation, partnership, limited liability company, or other entity authorized by the CBOE rules to hold a permit.

<sup>120</sup> 15 U.S.C. 78c(a)(3)(A). As described in Section II.C.2 above (Nomination and Election of Directors), the selection process for Representative Directors for the CBOE Board addresses the fair representation requirement for members contained in Section 6(b)(3) of the Act. 15 U.S.C. 78f(b)(3). See also supra note 39 (defining “Trading Permit Holder”).

<sup>121</sup> See proposed CBOE Rule 3.1(a)(iii).

<sup>122</sup> This change will cause a significant number of the Exchange’s rules to be amended. The Exchange intends to submit a separate filing to change the term “member” to “Trading Permit Holder” in the remainder of its rules and forms, as well as to make certain other related conforming changes.

<sup>123</sup> See proposed CBOE Rule 3.1(a)(iv).



of one month, three months, and one year, and would announce in a circular the types of permits it has determined to offer.<sup>124</sup> Trading Permits would be subject to such fees and charges as are established by the Exchange from time to time.<sup>125</sup>

The Exchange would have the authority to increase the number of any type of Trading Permit it has determined to issue.<sup>126</sup> The Exchange also would have the authority to limit or reduce the number of any type of Trading Permit it has determined to issue,<sup>127</sup> although the Exchange would be prohibited from eliminating or reducing the ability to trade one or more product(s) of a person currently trading such product(s) and would be prohibited from eliminating or reducing the ability to act in one or more trading function(s) of a person currently acting in such trading function(s), unless the Exchange is permitted to do so pursuant to a rule

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<sup>124</sup> See Notice, *supra* note 4, 73 FR at 51663.

<sup>125</sup> See proposed CBOE Rule 3.1(a)(v). The Exchange would be required to file proposed rule changes under Section 19(b) of the Act, 15 U.S.C. 78s(b), including, as applicable, Section 19(b)(3)(A)(ii), 15 U.S.C. 78s(b)(3)(A)(ii), to establish or change the fees for the types of Trading Permits it determines to issue.

<sup>126</sup> See proposed CBOE Rule 3.1(a)(vii).

<sup>127</sup> See proposed CBOE Rule 3.1(a)(vi). The Exchange would only be permitted to limit or reduce the number of any type of Trading Permit in a manner that complies with Section 6(c)(4) of the Act (15 U.S.C. 78f(c)(4)). See proposed CBOE Rule 3.1(a)(vi). The Exchange would retain the authority to take any action (remedial or otherwise) under the Act, the Bylaws, and the Rules. For example, the Exchange would continue to have the authority to take disciplinary action against a person over which the Exchange has jurisdiction. See proposed CBOE Rule 3.1(a)(ix).

As noted in a letter submitted by the Exchange to the Commission in connection with SR-CBOE-2006-106, CBOE has been unable to locate records that reflect with certainty the number of CBOE memberships on May 1, 1975. See Letter from Joanne Moffic-Silver, Executive Vice President, General Counsel and Corporate Secretary, CBOE, to Richard Holley III, Senior Special Counsel, Division of Market Regulation, Commission, dated November 2, 2007 (<http://www.sec.gov/comments/sr-cboe-2006-106/cboe2006106-161.pdf>). The closest date to May 1, 1975 for which CBOE has been able to locate records that CBOE believes can be relied upon to establish this information is June 30, 1975. Specifically, CBOE has financial statements as of June 30, 1975, the end of its then fiscal year, which set forth this information as of that date. The number of CBOE memberships on June 30, 1975 was 1,025.

filing submitted to Commission under Section 19(b) of the Act.<sup>128</sup> The Exchange would announce in a circular any limitation or reduction in the number of Trading Permits it seeks to impose. In addition, the Exchange would have the authority, pursuant to a rule filing submitted to the Commission under Section 19(b) of the Act,<sup>129</sup> to establish objective standards that must be met to obtain or renew a Trading Permit.<sup>130</sup>

Trading Permits could not be leased or transferred to any person except that an organization holding a Trading Permit may change the designation of the nominee in respect of each Trading Permit it holds or a Trading Permit Holder may, with the prior written consent of the Exchange, transfer a Trading Permit to a Trading Permit Holder organization or to an organization approved to be a TPH organization which is an affiliate or which continues substantially the same business without regard to the form of the transaction used to achieve such continuation.<sup>131</sup>

(2) Issuance of Trading Permits

In connection with the Restructuring Transaction, each current member of the Exchange that has the ability to trade would be eligible to receive a Trading Permit. Specifically, provided such person submits a post-Restructuring Transaction trading application to the Exchange,<sup>132</sup> is in good standing as of the date of the Restructuring Transaction, complies with the application procedures established by the Exchange, and pays any applicable fees, the Exchange would issue

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<sup>128</sup> 15 U.S.C. 78s(b).

<sup>129</sup> 15 U.S.C. 78s(b).

<sup>130</sup> See proposed CBOE Rule 3.1(a)(viii). Rule 3.1 provides that notwithstanding Rule 3.1 and Rule 3.1A (which addresses the issuance of Trading Permits to current members) nothing in those rules would eliminate or restrict the Exchange's authority to delist any product or to take any action under the Act, the Bylaws and the Rules. See proposed CBOE Rule 3.1(a)(ix).

<sup>131</sup> See proposed CBOE Rule 3.1(d)(ii).

<sup>132</sup> See proposed CBOE Rule 3.1A(a).

to such person a Trading Permit in respect of: (A) each membership not subject to an effective lease as of the date of the Restructuring Transaction that is owned by the applicant; (B) each membership that is leased as a lessee by the applicant as of the date of the Restructuring Transaction; (C) each trading permit issued by the Exchange prior to the Restructuring Transaction that is held by the applicant,<sup>133</sup> provided that in the case of a CBSX trading permit, the Exchange would issue a Trading Permit in respect of the CBSX trading permit that only provides the right to effect transactions on the CBSX;<sup>134</sup> and (D) each Temporary Membership held pursuant to Interpretation and Policy .02 of CBOE Rule 3.19.<sup>135</sup> Trading Permits also would be available, pursuant to an application process, to persons seeking trading access to the Exchange for the first time, as well as persons seeking to obtain additional Trading Permits.

Persons who are issued Trading Permits as set forth above would have the ability pursuant to those Trading Permits to continue trading any product, and acting in any trading function, that those persons traded, or acted in, at the time of the Restructuring Transaction.<sup>136</sup>

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<sup>133</sup> See Securities Exchange Act Release No. 58178 (July 17, 2008), 73 FR 42634 (July 22, 2008) (SR-CBOE-2008-40) (approving issuance of 50 Interim Trading Permits “ITPs”). Pursuant to Rule 3.27, the Exchange was authorized to issue ITPs to address the demand for trading access to the Exchange to the extent that a shortage exists from time to time in the number of transferable Exchange memberships available for lease.

<sup>134</sup> CBOE Rule 3.26, which currently provides for the issuance of CBSX trading permits, would be deleted as part of this rule filing because all Trading Permits after the Restructuring Transaction would be issued under proposed CBOE Rule 3.1. For the same reason, CBOE Rule 3.27, which currently provides for the issuance of Interim Trading Permits, also would be deleted.

<sup>135</sup> A person who was eligible to receive Trading Permit(s) pursuant to any of these provisions but who failed to comply with the application or other requirements must submit an application for a new Trading Permit and must go through the approval process to hold a Trading Permit. See proposed CBOE Rule 3.1A(c).

<sup>136</sup> This guarantee is subject to Rule 3.1(a)(iv), which provides that nothing in Rules 3.1 or 3.1A would eliminate or restrict the Exchange’s authority to delist any product or to take any action (remedial or otherwise) under the Act, the Bylaws, and the Rules, including without limitation the Exchange’s authority to take disciplinary or market performance actions against a person with respect to which the Exchange has jurisdiction under the Act, the Bylaws, and the Rules. See supra note 130. In addition, this guarantee is subject to the continuing satisfaction of any

The Exchange would have the ability to issue one or more types of Trading Permits through either a random lottery process or an order in time process.<sup>137</sup> In connection with an issuance of such Trading Permits, a Qualified Person<sup>138</sup> and any affiliated Qualified Person would be eligible to receive no more than the greater of 10 such Trading Permits or 20% of the number of Trading Permits issued at any given time.<sup>139</sup> This limit, however, would not apply in the event the number of permits to be issued exceeds the demand for such permits, in which case permits would be made available through the order in time process.<sup>140</sup>

The Exchange would automatically renew a Trading Permit for the same term as the expiring term,<sup>141</sup> unless, with advance notice to the Exchange and in a form and manner

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applicable qualification requirements, as well as to the Exchange's ability discussed above to limit or reduce the number of any type of Trading Permit pursuant to a rule filing with the Commission. See proposed CBOE Rules 3.1A(a) and 3.1(a)(vi).

<sup>137</sup> See proposed CBOE Rule 3.1(b)(iii). The Exchange also would have the authority to modify these processes or to establish any other objective process to issue Trading Permits pursuant to a rule filing submitted to the Commission under Section 19(b) of the Act (15 U.S.C. 78s(b)).

The Exchange in its discretion may maintain a waiting list to be used to issue Trading Permits pursuant to the order in time process. See proposed CBOE Rule 3.1(b)(ii). If the Exchange maintains a waiting list, Qualified Persons would be placed on that waiting list based on the order in time that such persons submitted applications, and such persons may at any time voluntarily withdraw from that waiting list. A person on the waiting list would be permitted to adjust the number of Trading Permits that such person would like to receive at any time prior to an announcement of an issuance of such Trading Permits.

<sup>138</sup> See proposed CBOE Rule 8.1(b)(i) (defining Qualified Person).

<sup>139</sup> See proposed CBOE Rule 3.1(b)(iii).

<sup>140</sup> See id.

<sup>141</sup> See proposed CBOE Rule 3.1(c)(iii). In renewing a Trading Permit, the Exchange would have the authority to issue one or more Trading Permits that represent the same or more trading right(s) as the expiring permit. See proposed CBOE Rule 3.1(c)(ii). To the extent the Exchange determines to issue one or more Trading Permits that represent the same or more trading right(s) as an expiring Trading Permit, the Exchange would provide all holders of that type of expiring Trading Permit with the new Trading Permit(s).

prescribed by the Exchange, the holder seeks to terminate the permit<sup>142</sup> or seeks to change the type of Trading Permit held.<sup>143</sup>

The Commission finds that the proposed CBOE rules governing the nature and issuance of Trading Permits are consistent with the Act, including Section 6(b)(2) of the Act,<sup>144</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer may become a member and any person may become associated with an exchange member.<sup>145</sup> The Commission notes that pursuant to Section 6(c) of the Act,<sup>146</sup> an exchange must deny membership to non-registered broker-dealers and registered broker-dealers that do not satisfy certain standards, such as financial responsibility or operational capacity.

(3) Tier Appointments

The Exchange has proposed a new type of appointment called a “tier appointment” for a market-maker seeking to trade one or more options classes.<sup>147</sup> Tier appointments would be subject to an application process similar to the process applicable for Trading Permits (*i.e.*, the random lottery or order in time processes).<sup>148</sup> Notwithstanding this application requirement, in the event a current member of the Exchange at the time of the Restructuring Transaction is trading an options class with respect to which the Exchange is establishing a tier appointment, the Exchange in connection with the Restructuring Transaction would issue to that member such

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<sup>142</sup> See proposed CBOE Rule 3.1(c)(i).

<sup>143</sup> See proposed CBOE Rule 3.1(c)(ii).

<sup>144</sup> 15 U.S.C. 78f(b)(2).

<sup>145</sup> See, e.g., BATS Exchange Registration Order and Nasdaq Exchange Registration Order, *supra*, note 78, 73 FR at 59502 and 71 FR at 3555, respectively.

<sup>146</sup> 15 U.S.C. 78f(c).

<sup>147</sup> See proposed CBOE Rule 8.3.

<sup>148</sup> See proposed CBOE Rule 8.3(e).

tier appointment, provided that the Exchange is notified of that member's desire to hold such a tier appointment.<sup>149</sup> Tier appointments would be in addition to the current appointment cost process set forth in CBOE Rule 8.3, which would remain unchanged.<sup>150</sup>

Market-makers would be required to designate a Trading Permit with which a tier appointment would be associated and could designate no more than one tier appointment per Trading Permit.<sup>151</sup> Tier appointments would be for the same term as the Trading Permit with which the tier appointment is associated. Termination, change, renewal, and transfer of tier appointments would be subject to the same terms and conditions as the processes for Trading Permits.<sup>152</sup> The Exchange would have the authority to establish, increase, limit, or reduce the number of a type of tier appointment and to establish objective standards for a market-maker to be issued, or to have renewed, a particular type of tier appointment.<sup>153</sup> Tier appointments would be subject to such fees and charges as are established by the Exchange from time to time.<sup>154</sup>

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<sup>149</sup> See proposed CBOE 3.1A(b).

<sup>150</sup> In general, under that process, the number of memberships owned or leased by a market-maker serves as the basis for determining the number/types of options classes that the market-maker can trade. In this regard, each membership held by a market-maker has an appointment credit of 1.0, and each option listed on the Exchange has an assigned appointment cost. Under that process, for example, a Market-Maker with one membership could trade options on the Nasdaq 100 Index, which has an appointment cost of .50, and options on the CBOE Volatility Index, which also has an appointment cost of .50. See Notice, supra note 4, 73 FR at 51665.

<sup>151</sup> See proposed CBOE Rule 8.3(e).

<sup>152</sup> For example, if a holder of a tier appointment does not notify the Exchange that the holder wants to terminate that tier appointment and does not file an application to replace that tier appointment, that tier appointment would be renewed along with its associated Trading Permit for the same term as the expiring term of that Trading Permit.

<sup>153</sup> See proposed Rule 8.3 that provides that notwithstanding the rule, nothing therein would eliminate or restrict the Exchange's authority to delist any product or to take any action under the Act, the Bylaws and the Rules. The application process and issuance of tier appointments as specified in Rule 8.3 would be in accordance with, and subject to the same terms and conditions as, the issuance process set forth for Trading Permits in Rule 3.1(b). Termination, change, renewal, and transfer of tier appointments would be in accordance with, and subject to the same terms and conditions as, the process set forth for Trading Permits in Rule 3.1(c) and (d). If it

The Commission finds that the proposed CBOE rules governing tier appointments are consistent with the Act, including Section 6(b)(2) of the Act,<sup>155</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer may become a member. In particular, the proposal would preserve the existing appointments of current CBOE market-makers, and any new or expanded tier appointments would be allocated in accordance with, and subject to the same terms and conditions as, the issuance process set forth for Trading Permits in Rule 3.1(b). To the extent the Exchange seeks to limit or reduce any type of tier appointment, the Commission notes that the Exchange would need to do so in an equitable and not unfairly discriminatory manner and file any such proposal with the Commission pursuant to Section 19 of the Act.

**F. Other Changes to the Rules**

(1) Chapter I of the Rules

The Exchange has proposed amended definitions in Chapter I to reflect the use of Trading Permits.<sup>156</sup> The Exchange also proposed a definition of its new “TPH Department,”<sup>157</sup> which would serve as the successor to CBOE’s Membership Department and would continue the

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seeks to limit or reduce the number of a type of tier appointment, or establish other objective standards governing issuance and/or renewal of a particular type of tier appointment, the Exchange first would need to file with the Commission a proposed rule change under Section 19(b) of the Act, 15 U.S.C. 78s(b).

<sup>154</sup> The Exchange would be required to file proposed rule changes under Section 19(b) of the Act, 15 U.S.C. 78s(b), including, as applicable, Section 19(b)(3)(A)(ii), 15 U.S.C. 78s(b)(3)(A)(ii), to establish and change the fees for the types of Trading Permits it has determined to issue.

<sup>155</sup> 15 U.S.C. 78f(b)(2).

<sup>156</sup> For example, the Exchange proposed to delete the terms “Lessor” and “Lessee” (since these concepts would not exist after the Restructuring Transaction) and added proposed definitions of “person,” “Trading Permit,” and “Trading Permit Holder.” See proposed CBOE Rules 1.1(ff) and (gg). A “person” would be defined as an individual, partnership (general or limited), joint stock company, corporation, limited liability company, trust or unincorporated organization, or any governmental entity or agency or political subdivision thereof.

<sup>157</sup> See proposed CBOE Rule 1.1(iii) (defining TPH Department).

functions of that department, such as processing applications for Trading Permits. The Commission finds the proposed changes to Chapter I of CBOE’s rules to be consistent with the Act as they are necessary to update the terms used in the rules and would assist Trading Permit Holders and the public in understanding the application and scope of CBOE’s rules.

(2) Chapter II of the Rules

CBOE has proposed several clarifying amendments to CBOE Rule 2.1, including limiting its scope to Exchange committees (i.e., committees that are not solely composed of CBOE directors) and clarifying the manner of appointment to such committees to reflect the fact that the Vice Chairman of the Board, with the approval of the CBOE Board, would appoint the chairmen and members of committees (other than the BCC)<sup>158</sup> unless otherwise provided by the rules of CBOE or by the CBOE Board.<sup>159</sup> CBOE has also proposed to streamline the process for filling vacancies on Exchange committees (other than the BCC)<sup>160</sup> and would provide that a majority would generally constitute a quorum for committee meetings.<sup>161</sup> The proposed revision would also clarify that committees could take all types of actions, not only “informal” actions, pursuant to written consent.<sup>162</sup>

Further, CBOE has proposed to clarify certain aspects of the authority of the CBOE Board over committees, including a clarification that the CBOE Board may delegate powers and duties to the committees and that each Exchange committee is subject to the control and

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<sup>158</sup> After the Restructuring Transaction, the President, with approval of the Board, would continue to have the authority to appoint members to the Business Conduct Committee. See proposed CBOE Rules 2.1(a). See also Notice, supra note 4, 73 FR at 51666.

<sup>159</sup> See proposed CBOE Rule 2.1(a).

<sup>160</sup> See id.

<sup>161</sup> See proposed CBOE Rule 2.1(b).

<sup>162</sup> See proposed CBOE Rules 2.1(b).



supervision of the CBOE Board.<sup>163</sup> CBOE proposed to clarify that the CBOE Board has the authority to review, modify, suspend, or overrule any and all actions of any committee, officer, representative, or designee of the Exchange taken pursuant to the rules in accordance with any applicable review procedures specified in the rules.<sup>164</sup> Finally, CBOE proposed conforming changes to the rules in Chapter II to reflect the use of the term Trading Permits.<sup>165</sup>

The Commission finds that the proposed changes to Chapter II of CBOE's rules are consistent with the Act in that they clarify the operation of Exchange committees and the authority of the CBOE Board and also update the terms used in the rules to reflect the proposed Restructuring Transaction, therein clarifying the application and scope of CBOE's rules.

(3) Chapter III of the Rules

CBOE has proposed conforming changes to certain rules in Chapter III to reflect the change from memberships to Trading Permits without changing the substance of these rules.<sup>166</sup> In addition, the process for designating nominees for Trading Permits in CBOE Rule 3.8 would be amended to require an organization to designate as its nominee an associated person who is an

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<sup>163</sup> See proposed CBOE Rules 2.1(d) and 2.1(e).

<sup>164</sup> See proposed CBOE Rule 2.2.

<sup>165</sup> For example, references to the term "dues" have been deleted in CBOE Rules 2.20, 2.22, and 2.23 because this term generally refers to payments made by members in a membership organization. This change also has been made to other rules in Chapters I-III. See, e.g., CBOE Rule 1.1(jj).

<sup>166</sup> For example, rules relating to the sale, transfer, and lease of memberships, and to the member death benefit would be deleted, because they would not be applicable to Trading Permits. See, e.g., CBOE Rules 3.12-3.15. CBOE Rules 3.24 (regarding member death benefit) and 3.25 (regarding transfer of memberships in trust) would also be deleted. In addition, CBOE Rule 3.1, which was designed to, among other things, ensure that memberships were used for trading on the Exchange, would be replaced with a new version as this requirement would not be necessary in the context of Trading Permits that, unlike memberships, are directly linked to having a trading function on the Exchange. Other conforming changes are being proposed to CBOE Rules 3.2 and 3.3 (relating to the qualifications to be a member or member organization, and the application process to become a member; 3.5 (relating to the authority of the Exchange to deny or condition persons from becoming or being associated with Trading Permit Holders); 3.18 (regarding statutory disqualification); and Rule 3.10 (regarding status of Trading Permit Holders).

individual holder of a Trading Permit.<sup>167</sup> Further, the Exchange proposes to streamline the process of designating nominees for organizations that have multiple Trading Permits in their name. As modified, CBOE Rule 3.8(a)(ii) would allow organizations to designate the same individual to be the nominee for Trading Permits held in its name, including Trading Permits used for trading in open outcry on the trading floor.<sup>168</sup>

The Exchange also is deleting the requirement in CBOE Rule 3.7(g) that a member keep and maintain a current copy of the CBOE Constitution and rules in a readily accessible place and available for examination by customers. CBOE believes that, because it is required to maintain a copy of its governing documents and rules online, this requirement is no longer necessary.<sup>169</sup> Finally, the Exchange is amending CBOE Rule 3.9 to, among other things, delete the requirement that the Exchange post notices of applications on the Exchange Bulletin Board, as it believes that use of a physical bulletin board at the Exchange to notify persons is outdated in the era of electronic and remote trading.<sup>170</sup>

**G. Request for Commission Approval under Section 15.16 of the CBSX Operating Agreement**

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<sup>167</sup> See CBOE Rule 3.8(a). References to registering a membership for a member organization would be deleted because that concept would have no application once Trading Permits are used to provide trading access to the Exchange. See proposed CBOE Rule 3.8. The Exchange also would make this change to other rules in Chapters I-III and to CBOE Rule 8.3. See Notice, supra note 4, 73 FR at 51667, n.180.

<sup>168</sup> Under the existing rule, a member organization that has multiple memberships in its name can designate the same individual to be the nominee for those memberships, except that for each membership used for trading in open outcry on the trading floor, the member organization must designate a different individual to be the nominee for each of those memberships.

<sup>169</sup> See Notice, supra note 4, 73 FR at 51667.

<sup>170</sup> The information would continue to be published in the electronic Exchange Bulletin. See CBOE Rule 3.9(e). The Exchange also would post notices of the effectiveness of Trading Permit Holder status or approval of a trading function in the Exchange Bulletin. See proposed CBOE Rule 3.11.

Under the CBSX Operating Agreement, CBOE is defined as one of the “Owners” of CBSX. Section 15.16 of the CBSX Operating Agreement provides that, in the event that a person acquires a 25% or greater interest in an Owner that owns a 20% or greater interest in CBSX, that person must execute an amendment to the Operating Agreement in which that person agrees to be a party to the Operating Agreement and to abide by all of the provisions of the Operating Agreement. Section 15.16 also provides that Commission approval under Section 19 of the Act is required in connection with such an amendment to the Operating Agreement.<sup>171</sup> Because CBOE owns a 50% interest in CBSX, the establishment of CBOE Holdings as the sole shareholder of CBOE would trigger this Commission approval requirement. Consistent with this requirement in Section 15.16 of the CBSX Operating Agreement, CBOE has requested as part of this proposed rule change that the Commission provide such approval.

The provision in the CBSX Operating Agreement requiring Commission approval of an amendment to the CBSX Operating Agreement to effectuate a change in control was designed to involve the Commission and CBOE in assessing the potential conflicts of control that could arise. In the case of the Restructuring Transaction, CBOE would become wholly-owned by CBOE Holdings. However, as discussed in detail above, CBOE Holdings would be subject to a number of conditions designed to protect the regulatory independence of CBOE in recognition of its status as an SRO. Accordingly, the Commission finds that the amendment to the CBSX Operating Agreement with respect to the change in control of CBOE in connection with the Restructuring Transaction is consistent with the Act.

#### **H. Accelerated Approval**

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<sup>171</sup> 15 U.S.C. 78s.

CBOE has asked the Commission to grant accelerated approval of the proposal, as modified by Amendment No. 1. As set forth below, the Commission finds good cause for approving the proposal, as modified by Amendment No. 1, prior to the thirtieth day after publishing notice of Amendment No. 1 in the Federal Register.<sup>172</sup>

In Amendment No. 1, CBOE proposed the following modifications to the proposed CBOE Holdings governing documents: (1) issuance of a single class of common stock of CBOE Holdings, rather than different series of common stock as was originally proposed; (2) minor revisions to the transfer restrictions on common stock; (3) incorporation of the term “Regulated Securities Exchange Subsidiary,” rather than “CBOE,” to accommodate the potential future ownership of more than one national securities exchange by CBOE Holdings; (4) requiring that shares of stock issued in connection with the Restructuring Transaction be recorded on the books and records of CBOE Holdings only in the name of the owner of the shares to ensure compliance with the transfer restrictions; (5) changes to the size of the CBOE Holdings Board and term of its Directors; (6) defer for one year the date of the first annual meeting of CBOE Holdings stockholders, and thus the first election of post-Restructuring Transaction directors; (7) changes to the content of the notice stockholders must submit in connection with director nominations or stockholder requests to bring matters before the annual stockholder meeting; (8) the ability to set separate record dates for stockholder notice of a stockholder meeting and for voting purposes; (9) specify that two-thirds of CBOE Holdings directors must satisfy the independence requirements contained in the listing standards of either NYSE or The Nasdaq Stock Market; (10) modify the “for cause” removal standard applicable to directors in light of the change to one-year terms for

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<sup>172</sup> 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of notice thereof, unless the Commission finds good cause for so doing.

directors; (11) delete the requirement that at least one director on the CBOE Holdings Compensation Committee be the beneficial owner of CBOE Holdings stock; (12) changes to the size of the CBOE Holdings Nominating and Governance Committee; and (13) make certain technical, non-substantive wording changes.

In addition, Amendment No. 1 proposes the following changes to the proposed CBOE governing documents: (1) changes to the size of the CBOE Board and term of its Directors; (2) defer for one year the date of the first annual meeting of CBOE stockholders, and thus the first election of post-Restructuring Transaction directors; (3) modify the “for cause” removal standard applicable to directors in light of the change to one-year terms for directors; (4) delete the requirement that at least one director on the CBOE Compensation Committee be the beneficial owner of CBOE Holdings stock; (5) change the requisite number of directors on the Regulatory Oversight Committee from four to three; (6) revise the provision dealing with the duties and powers of the CBOE Treasurer to make the provision the same as a similar provision set forth in the CBOE Holdings corporate documents; and (7) correct non-substantive typographical errors.

Finally, Amendment No. 1 seeks to make the following changes to the proposed CBOE Rules: (1) adopt a rule governing the permissible uses of regulatory revenues; and (2) make certain changes to reflect intervening proposed rule changes that have been submitted since CBOE filed its proposal.

The Commission believes that the changes contained in Amendment No. 1 are consistent with the Act. The Commission notes that the changes proposed in Amendment No. 1 are either not material or are otherwise responsive to the concerns of the Commission and do not raise any regulatory concerns. In addition, the Commission notes that the initial proposed rule change was published for comment with a comment period ending on September 25, 2008 and the

Commission did not receive any comments on the proposal. Accordingly, the Commission finds that good cause exists for approving the proposed rule change, as amended, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.<sup>173</sup>

### **III. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2008-88 on the subject line.

#### Paper Comments:

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

All submissions should refer to File Number SR-CBOE-2008-88. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those

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<sup>173</sup> 15 U.S.C. 78s(b)(2).

that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2008-88 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

#### **IV. Conclusion**

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>174</sup> that the proposed rule change (SR-CBOE-2008-88), as modified by Amendment No. 1, be and hereby is approved on an accelerated basis.

By the Commission.

Elizabeth M. Murphy  
Secretary

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<sup>174</sup> 15 U.S.C. 78s(b)(2).