

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50874; File No. SR-CBOE-2004-66)

December 16, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by Chicago Board Options Exchange, Incorporated Relating to Borrowing and Lending by Registered Persons

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 18, 2004, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

CBOE proposes to adopt a new rule restricting registered persons of members or member organizations from borrowing from or lending to their customers, except pursuant to the conditions specified in the rule. The text of the proposed rule change is available at the Office of the Secretary, CBOE, and at the Commission.

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

In its filing with the Commission, CBOE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item I above.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposed rule change is to adopt a rule that prohibits registered persons of CBOE members or member organizations from borrowing money from or lending money to a customer unless each of the following applies: (1) the member or member organization has written procedures allowing such borrowing or lending arrangements; and (2) the borrowing or lending arrangements fall within one of five permissible types of lending arrangements.³ In certain of these cases, the member or member organization must also pre-approve the loan in writing. The five types of permissible lending arrangements are:

- i) the customer is a member of the registered person's immediate family (as defined in the proposed rule);
- ii) the customer is a financial institution regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business;
- iii) the customer and the registered person are both registered persons of the same member organization;
- iv) the lending arrangement is based on a personal relationship outside of the broker-customer relationship; or

³ The proposed rule is substantially similar to NASD Rule 2370. See Securities Exchange Act Release No. 48424 (August 29, 2003), 68 FR 52806 (September 5, 2003). NASD Rule 2370 was amended in Securities Exchange Act Release No. 49269 (February 18, 2004), 69 FR 8718 (February 25, 2004).

- v) the lending arrangement is based on a business relationship outside of the broker-customer relationship.

CBOE believes that the solicitation of loans from customers by registered persons is an area of legitimate CBOE interest because of the potential for misconduct. CBOE has brought disciplinary action against registered persons who have violated just and equitable principles of trade by taking unfair advantage of their customers by inducing them to lend money in disregard of the customers' best interests, or by borrowing funds from, but not repaying, customers. The potential for misconduct also exists when a registered person lends money to a customer.

The proposed rule change establishes a regulatory framework that would give members and member organizations greater control over, and more specific supervisory responsibilities for, lending arrangements between registered persons and their customers. Members and member organizations could choose to permit their registered persons to borrow from or lend to customers consistent with the requirements of the rule or, as was the case before the proposal of this new rule, prohibit the practice in whole or in part. If members or member organizations choose to permit their registered persons to engage in lending arrangements with customers, the proposed rule change would require members and member organizations to have written procedures allowing the borrowing and lending of money between registered persons and customers or the member or member organization. As stated above, members and member organizations would be permitted to approve loans only if the loan falls within one of the five types of permissible lending arrangements set forth in the rule.

The proposed rule would require members and member organizations to pre-approve in writing three out of the five types of lending arrangements permitted by the rule. It would exempt from the rule's notice and approval requirements lending arrangements involving a registered person

and his/her customer that is: (1) a member of his/her immediate family (as defined in the proposed rule); or (2) a financial institution regularly engaged in the business of providing credit, financing, or loans (or other entity or person that regularly arranges or extends credit in the ordinary course of business), provided the loan has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose, and creditworthiness. The Exchange believes the requirement in the proposed rule that certain types of lending and borrowing arrangements must be pre-approved by the member or member organization would enhance members' and member organizations' ability to supervise such lending and borrowing activities of registered personnel.

CBOE also believes that, the proposed rule change would also enhance the Exchange's ability to monitor loans between registered persons and their customers. Currently, under controlling Commission decisions, to bring a disciplinary action against a registered person who has entered into an unethical lending arrangement with a customer, CBOE generally must prove that the arrangement is inconsistent with just and equitable principles of trade under CBOE Rule 4.1 because the registered person has acted in bad faith or unethically. This can be difficult to prove in cases in which the customer is unable or unavailable to testify, or refuses to testify because he or she is relying on the registered person for financial advice. The proposed rule change would better enable CBOE to monitor and bring disciplinary actions in cases involving such loans.

The Exchange notes that the safeguards provided under the proposed rule, including bringing disciplinary actions for violations of the rule, are in addition to the general powers that CBOE has to bring a disciplinary action against a registered person who has entered into an unethical lending arrangement with a customer under CBOE Rule 4.1. It is also important to note that this proposal does not change the application of Regulation T to lending activities by associated persons.

Specifically, the definition of "creditor" under Regulation T extends to associated persons of broker-dealers and therefore, certain loans to customers by associated persons may require compliance with the provisions of Regulation T.

2. Statutory Basis

CBOE believes the proposed rule change is consistent with Section 6(b) of the Act, in general, and furthers the objectives of Section 6(b)(5) of the Act, which requires, among other things, that CBOE's rules be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest. CBOE believes the proposed rule change is designed to accomplish these ends by establishing a regulatory framework that will give members greater control over lending arrangements by permitting members to permit such arrangements only if they fall within one of five types of permissible arrangements, or, as was the case before the proposal of this new rule, prohibit such arrangements altogether. Members that permit such arrangements would be required to keep written procedures. These procedures would enable both members and CBOE to proscribe certain customer-broker loans and monitor those that have been approved.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

CBOE has stated that the foregoing proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁴ and Rule 19b-4(f)(6) thereunder⁵ because the proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date of filing, or such shorter time that the Commission may designate if consistent with the protection of investors and the public interest. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in the furtherance of the purposes of the Act.⁶

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the 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. Please include File Number SR-CBOE-2004-66 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange

⁴ 15 U.S.C. 78s(b)(3)(A).

⁵ 17 CFR 240.19b-4(f)(6).

⁶ 15 U.S.C. 78s(b)(3)(C).

Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-66. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of 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-2004-66 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).