

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64127; File No. SR-CBOE-2011-010)

March 25, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, Relating to Bylaw and Related Rule Changes

I. Introduction

On January 27, 2011, Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to modify its governance structure. On February 9, 2011, the Exchange filed Amendment No. 1 to the proposed rule change.³ The proposed rule change was published for comment in the Federal Register on February 10, 2011.⁴ The Commission received no comment letters regarding the proposal. This order approves the proposed rule change, as modified by Amendment No. 1.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ At the time CBOE submitted the original proposed rule change, CBOE had not yet obtained formal approval from its Board of Directors for the specific Bylaw and rule changes set forth in this proposed rule change. CBOE stated that once that approval was obtained, the Exchange would file a technical amendment to its proposed rule change to reflect that approval. In Amendment No. 1, the Exchange notes that the CBOE Board of Directors approved the specific Bylaw and rule changes set forth in SR-CBOE-2011-010 on February 8, 2011 and stated that no further action was necessary in connection with its proposal. Amendment No. 1 is technical in nature, and the Commission is not publishing Amendment No. 1 for public comment.

⁴ See Securities Exchange Act Release No. 63844 (February 4, 2011), 76 FR 7610 (“Notice”).

II. Description of the Proposal

The Exchange proposes to: (1) eliminate the CBOE Office of the Vice Chairman of the Board (“Vice Chairman”); (2) eliminate the CBOE Trading Advisory Committee and provide that the Board of Directors may establish an Advisory Board instead; (3) eliminate the CBOE Audit Committee; and (4) conform the composition requirements for the CBOE Board of Directors and Executive Committee to the composition requirements of the Board of Directors and Executive Committee of its affiliate C2 Options Exchange, Incorporated (“C2”).

A. Elimination of the Office of the Vice Chairman of the Board

The Exchange proposes to amend its Bylaws to eliminate the office of the Vice Chairman.⁵ Historically, the Vice Chairman’s primary function was to facilitate communication between the Exchange and its membership, including lessor members that owned memberships and leased them to trading members, and to coordinate the activities of member committees.⁶ According to the Exchange, the role of the Vice Chairman has been significantly reduced since the Exchange changed its structure from a membership organization to a stock corporation owned by a public holding company, CBOE Holdings, Inc. (“CBOE Holdings”).⁷ The Exchange has represented that CBOE will continue to obtain input from Trading Permit Holders through other channels, including direct communication with individual Trading Permit Holders,

⁵ The specific proposed Bylaw and rule changes relating to the elimination of the Office of the Vice Chairman are discussed in detail in the Notice. See Notice, supra note 4, 76 FR at 7610-7611.

⁶ Currently, the Vice Chairman is an office held by one of the Exchange’s Industry Directors. See Notice, supra note 4, 76 FR at 7610.

⁷ For example, the Exchange no longer has lessor members because they were made stockholders as part of CBOE’s restructuring, the Exchange’s trading members became Trading Permit Holders and there are fewer Trading Permit Holder Committees. See id.

committees established by the Exchange, and through the proposed Advisory Board (discussed below).⁸

B. Elimination of the Trading Advisory Committee and Provision for an Advisory Board

Section 4.7 of the CBOE Bylaws currently provides for a Trading Advisory Committee to advise CBOE's Office of the Chairman regarding matters of interest to Trading Permit Holders. Section 4.7 allows the Board of Directors to set the number of members of the Trading Advisory Committee, requires that the majority of the members of the Committee be involved in trading either directly or indirectly through their firms, states that the Chairman of the Committee is the Vice Chairman of the Board, and the Vice Chairman appoints the other members of the Committee with the approval of the Board.

In place of a Trading Advisory Committee, the Exchange proposes that the Board of Directors may establish an Advisory Board which would advise the Office of the Chairman regarding matters of interest to Trading Permit Holders. The Board of Directors would determine the number of members of the Advisory Board, the Chief Executive Officer or his or her designee would serve as the Chairman of an Advisory Board, and the CBOE Nominating and Governance Committee would recommend the members of any Advisory Board for approval by the Board of Directors.

The Advisory Board would be completely advisory in nature and would not be vested with any Exchange decision-making authority or other authority to act on behalf of the Exchange. Pursuant to proposed Section 6.1 of the Bylaws, the Board of Directors would have

⁸ See Notice, supra note 4, 76 FR at 7610.

the discretion as to whether (or not) to put an Advisory Board in place. CBOE has represented that the Board of Directors intends to establish an Advisory Board.⁹

C. Elimination of Exchange Audit Committee

CBOE proposes to amend its Bylaws to eliminate its Audit Committee because its functions are duplicative of the functions performed by the Audit Committee of its parent company, CBOE Holdings, Inc. (“CBOE Holdings”).

The CBOE Holdings Audit Committee has broad authority to assist the CBOE Holdings Board of Directors in discharging its responsibilities relating to, among other things: (1) the qualifications, engagement, and oversight of CBOE Holdings’ independent auditor; (2) CBOE Holdings’ financial statements and disclosure matters; (3) CBOE Holdings’ internal audit function and internal controls; and (4) CBOE Holdings’ oversight and risk management, including compliance with legal and regulatory requirements. CBOE Holdings’ financial statements are prepared on a consolidated basis that includes the financial results of CBOE Holdings’ subsidiaries, including CBOE. Therefore, according to the Exchange, the CBOE Holdings Audit Committee’s purview necessarily includes CBOE and the responsibilities of the CBOE Audit Committee are fully duplicated by the responsibilities of the CBOE Holdings Audit Committee.¹⁰ Consequently, CBOE proposes that the responsibilities of its audit committee be performed by CBOE Holdings audit committee.

Although the CBOE Holdings Audit Committee would continue to have overall responsibility with respect to the internal audit function, the CBOE Board of Directors would

⁹ See Notice, supra note 4, 76 FR at 7612.

¹⁰ See Notice, supra note 4, 76 FR at 7612 (noting that the CBOE Audit Committee has a more limited role focusing on: (1) CBOE’s financial statements and disclosure matters, and (2) CBOE’s oversight and risk management, including compliance with legal and regulatory requirements, in each case, only to the extent required in connection with CBOE’s discharge of its obligations as a self-regulatory organization).

maintain its own independent oversight over the internal audit function with respect to CBOE regulatory functions through the CBOE Regulatory Oversight Committee. Specifically, upon elimination of the CBOE Audit Committee, the Regulatory Oversight Committee would have the authority to review the internal audit plan relating to CBOE's regulatory functions and to request at any time that CBOE's internal auditor conduct an audit relating to those functions.¹¹

D. Composition Requirements for Board of Directors and Executive Committee

CBOE proposes to amend its Bylaws to conform the composition requirements of its Board of Directors and Executive Committee to the composition requirements of C2 Board of Directors and Executive Committee. Currently, CBOE's Bylaws require that the number of Non-Industry Directors on the CBOE Board of Directors may not be less than a majority of the members of the Board. Similarly, the Bylaws require that the majority of the directors serving on the CBOE Executive Committee must be Non-Industry Directors. Consistent with Sections 3.1 and 4.2 of the C2 Bylaws, CBOE proposes to change these provisions to provide that in no event shall the number of Non-Industry Directors on the CBOE Board or CBOE Executive Committee constitute less than the number of Industry Directors on the Board or Executive Committee, respectively (excluding the Chief Executive Officer from the calculation of Industry Directors for such purposes).

Under CBOE's proposal, the CBOE Bylaws would require that the Executive Committee include the Chairman of the 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

¹¹ These changes would be in addition to the CBOE's current Regulatory Oversight Committee charter provision, which provides that the Regulatory Oversight Committee shall meet regularly with CBOE's internal auditor regarding regulatory functions. CBOE's Regulatory Oversight Committee would continue its existing practice of reviewing internal audits of CBOE's regulatory functions. See Notice, supra note 4, 76 FR at 7612.

deems appropriate, provided that in no event would the number of Non-Industry Directors be less than the number of Industry Directors serving on the Executive Committee.¹²

CBOE believes that having the same composition requirements for CBOE Holdings' two affiliated exchange subsidiaries will promote consistency and efficiency. CBOE and C2 currently have the same individuals serving on the CBOE and C2 Boards and the CBOE and C2 Executive Committees.¹³

III. Discussion

After careful review of the proposal, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁴ In particular, the Commission finds that the proposal is consistent with Section 6(b)(1) of the Act,¹⁵ which requires a national securities exchange to be so organized and have the capacity to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act. The Commission further finds that the proposal is consistent with Section 6(b)(3) of the Act¹⁶ 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. The Commission also finds that the proposal is consistent with Section 6(b)(5) of the Act,¹⁷ which requires, among other things, that the rules of an

¹² See Notice, supra note 4, 76 FR at 7613.

¹³ See Notice, supra note 4, 76 FR at 7613.

¹⁴ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁵ 15 U.S.C. 78f(b)(1).

¹⁶ 15 U.S.C. 78f(b)(3).

¹⁷ 15 U.S.C. 78f(b)(5).

exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission finds that the proposed elimination of CBOE's Office of the Vice Chairman of the Board is consistent with the Act. As noted above, the Exchange believes that the role previously performed by the Vice Chairman of the Board can effectively be performed by CBOE management and the new Advisory Board. Accordingly, the Exchange seeks to eliminate this position to make its governance structure more streamlined and efficient. With respect to member input in the affairs of the Exchange, the Commission notes that the Exchange Bylaws will continue to require that at least 30% of the directors on the CBOE Board of Directors be Industry Directors and that at least 20% of CBOE's directors be Representative Directors.¹⁸ The Commission has previously noted that this requirement, consistent with Section 6(b)(3) of the Act,¹⁹ helps to ensure that an exchange's members have a voice in the governing body of the exchange and the corresponding exercise by the exchange of its self-regulatory authority, and that the exchange is administered in a way that is equitable to all who trade on its market or through its facilities.²⁰ The Commission believes that, despite the elimination of the

¹⁸ Representative Directors are Industry Directors nominated (or otherwise selected through a petition process) by the Industry-Director Subcommittee of the CBOE Nominating and Governance Committee. CBOE Trading Permit Holders may nominate alternative Representative Director candidates to those nominated by the Industry Director Subcommittee, in which case a Run-off Election would be held in which CBOE's Trading Permit Holders would vote to determine which candidates would be elected to the CBOE Board of Directors to serve as Representative Directors. See Notice, supra note 4, 76 FR at 7610.

¹⁹ 15 U.S.C. 78f(b)(3).

²⁰ See Securities Exchange Act Release No. 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) (File No. 191) (approving C2 as a national securities exchange) ("C2 Approval Order").

office of the Vice Chairman, CBOE governance will continue to provide for the fair representation of CBOE Trading Permit Holders in the selection of directors and the administration of the Exchange consistent with Section 6(b)(3) of the Act. Further, as discussed below, additional opportunities for member input could result from the proposed Advisory Board.

In addition, the Commission finds that the Exchange's proposal to authorize an Advisory Board to advise the Office of the Chairman regarding matters of interest to Trading Permit Holders is consistent with the Act. With respect to composition, the Nominating and Governance Committee will recommend members of the Advisory Board for approval by the Board of Directors.²¹ The Commission notes that the new Advisory Board will be advisory in nature and will not be vested with decision-making authority or the authority to act on behalf of the Exchange. Nevertheless, the Advisory Board could serve as a supplemental adjunct advisory body that can provide an additional forum for members to be heard and provide input to Exchange management above and beyond the formal role played by Representative Directors discussed above.

Further, the Commission finds that the proposed elimination of CBOE's audit committee is consistent with the Act. The Commission previously approved a structure in which certain committees of the board of directors of NYSE Euronext, including its audit committee, were authorized to perform functions for various subsidiaries, including the New York Stock

²¹ Persons interested in being considered for a seat on an Advisory Board could contact the Nominating and Governance Committee, but the Nominating and Governance Committee would have sole discretion in recommending members of the Advisory Board to the Board of Directors for approval.

Exchange, LLC.²² More recently, the Commission approved proposals by The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., and NASDAQ OMX PHLX, Inc. to eliminate their respective audit committees.²³ The responsibilities of the CBOE Audit Committee are fully duplicated by the CBOE Holdings Audit Committee. Further, the CBOE Regulatory Oversight Committee has broad authority to oversee the adequacy and effectiveness of CBOE's regulatory responsibilities and is able to maintain oversight over internal controls in tandem with the CBOE Holdings Audit Committee. Accordingly, elimination of the CBOE Audit Committee should not impact the ability of the CBOE Board or the CBOE Regulatory Oversight Committee to maintain substantial and independent oversight of the Exchange's regulatory program.

Finally, the Commission finds that the proposed changes to the compositional requirements for the CBOE Board of Directors and Executive Committee are consistent with the Act. The Commission notes these proposed changes are designed to align CBOE's compositional requirements with those of its affiliated exchange, which were previously approved by the Commission.²⁴ In addition, the change is similar to the treatment of "Staff Governors" that the Commission previously approved for another self-regulatory organization.²⁵

²² See Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (SR-NYSE-2006-120).

²³ See Securities Exchange Act Release Nos. 60276 (July 9, 2009), 74 FR 34840 (July 17, 2009) (SR-NASDAQ-2009-042), 60247 (July 17, 2009), 74 FR 33495 (July 13, 2009) (SR-BX-2009-021), and 60687 (September 18, 2009), 74 FR 49060 (September 25, 2009) (SR-Phlx-2009-59).

²⁴ See C2 Approval Order, *supra* note 20, 74 FR at 66701-66702 (noting that "requirement that the number of Non-Industry Directors equal or exceed the number of Industry Directors on the Board is designed to assure the inclusion of a significant non-industry presence in the governance of the Exchange, which the Commission believes is a critical element in the Exchange's ability to protect the public interest.").

²⁵ See Securities Exchange Act Release No. 44280 (May 8, 2001), 66 FR 26892 (May 15, 2001) (SR-NASD-2001-06)(approving amendment to NASD By-Laws to allow for the

Though, as revised, the Executive Committee would not have 20% of its members that are elected by Permit Holders (as the Board is required to have), CBOE has represented that the role of its Executive Committee does not involve it routinely acting in place of the Board. Rather, CBOE represented that its 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.²⁶ In addition, in situations when the Executive Committee does make a decision between CBOE Board meetings, the CBOE Board is generally aware ahead of time of the potential that the Executive Committee may need to make the decision. The CBOE Board is fully informed of any decision made by the Executive Committee at its next meeting and can always decide to review that decision and take a different action.²⁷ Accordingly, the CBOE Board, including the Representative Directors, will continue to have final say on any matter considered by the Executive Committee.

treatment of Staff Governors as “neutral” for purposes of Industry/Non-Industry balancing on the NASD Board of Governors).

²⁶ See Notice, supra note 4, 76 FR at 7613, n.6.

²⁷ CBOE previously noted the foregoing to the Commission and has represented that it continues to be the case. See Securities Exchange Act Release No. 62158 (May 24, 2010), 75 FR 30082, n.87 (May 28, 2010) (SR-CBOE-2008-88), see also Notice, supra note 4, 76 FR at 7613, n.6.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁸ that the proposed rule change (SR-CBOE-2011-010), as modified by Amendment No. 1, be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁹

Cathy H Ahn
Deputy Secretary

²⁸ 15 U.S.C. 78s(b)(2).

²⁹ 17 CFR 200.30-3(a)(12).