

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51033; File No. SR-NSX-2004-12)

January 13, 2005

Self-Regulatory Organizations; Order Granting Approval to a Proposed Rule Change by the National Stock Exchange to Eliminate the “CBOE Exerciser Member” Membership Class, to Eliminate the Exchange’s Special Nominating Committee, and to Remove Certain Special Restrictions on Changes to Certain NSX By-Laws and Rules

I. Introduction

On October 21, 2004, the National Stock Exchange (“NSX” 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 amend its by-laws and rules in order to eliminate the “CBOE Exerciser Member” membership class, to eliminate NSX’s Special Nominating Committee, and to remove certain special restrictions on making changes to various NSX by-laws and rules. Notice of the proposed rule change was published for comment in the Federal Register on December 10, 2004.³ No comments were received regarding the proposal. This order approves the proposed rule change.

II. Background

On November 14, 1986, the Cincinnati Stock Exchange (“CSE”), now known as the NSX, and CBOE entered into an agreement of affiliation pursuant to which CBOE currently holds 162 certificates of proprietary membership of NSX and CBOE and its members have certain rights associated with NSX. The rights CBOE gained as a result of the affiliation include the right for CBOE members to become Proprietary Members of NSX without having to purchase or own certificates of proprietary membership, provided that each such CBOE member

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 50796 (December 6, 2004), 69 FR 32639.

meets all other eligibility requirements for NSX membership (such CBOE members are referred to as “Proprietary Members without certificates” or “CBOE Exerciser Members”). CBOE also gained the right to hold six out of the thirteen seats on the NSX’s Board of Directors and the right to hold three of the six seats on the newly created Special Nominating Committee, which is tasked with nominating the Public Directors to the NSX board. Furthermore, as part of the agreement of affiliation, the NSX agreed to adopt special restrictions on amending certain provisions of the NSX by-laws and rules. These terms of the agreement of affiliation were implemented through changes to NSX’s by-laws and rules.⁴

NSX and CBOE recently agreed to amend and terminate certain aspects of their affiliation and entered into a termination of rights agreement on September 27, 2004 (“Termination Agreement”). Under the Termination Agreement, CBOE agreed to transfer certain of its certificates of proprietary membership to NSX and to relinquish certain rights associated with NSX in exchange for certain cash payments and other undertakings by NSX, subject to the terms and conditions set forth in the Termination Agreement. The initial closing for the Termination Agreement is conditioned upon Commission approval of the amendments to the NSX by-laws and rules contained in this proposed rule change.

III. Description of the Proposal

Under the proposal, NSX would eliminate the CBOE Exerciser Member membership class and the related special privilege for CBOE members to become NSX members without purchasing certificates of proprietary membership. In eliminating this class of membership and

⁴ See Securities Exchange Act Release Nos. 23868 (December 9, 1986), 51 FR 44958 (December 15, 1986) (notice of proposed changes to CSE by-laws and rules to implement agreement of affiliation) and 24090 (February 12, 1987), 52 FR 5225 (February 19, 1987) (order approving changes to CSE by-laws and rules to implement agreement of affiliation).

this special privilege, the Exchange would provide a transition period whereby all CBOE Exerciser Members would have ninety days from the date of the approval of this proposed rule change to purchase certificates of proprietary membership from NSX. During such ninety day period, a CBOE Exerciser Member who has not purchased a certificate of propriety membership would continue to have the rights and obligations of a Proprietary Member without certificate as those rights and obligations existed prior to the date of approval of this proposal. At the conclusion of the ninety day period, however, any CBOE Exerciser Member who does not own an NSX certificate of proprietary membership would automatically cease to qualify for membership on the Exchange and would not become a member of the Exchange again without first complying with all the procedures and requirements set forth in the NSX by-laws and rules to do so. In relation to the elimination of the membership class of CBOE Exerciser Members, NSX would also eliminate the “CBOE Exercise Application” fee and other references in its by-laws to “Proprietary Members without certificates.”

In addition, the proposal would eliminate NSX’s Special Nominating Committee, which is composed of two Designated Dealer Directors, the At-Large Director and three of the six CBOE Directors and which has the responsibility of nominating candidates for Public Director positions on the NSX board. NSX proposes to re-assign the responsibility of nominating Public Directors to the NSX’s Nominating Committee, which currently nominates candidates for the Designated Dealer Director and At-Large Director board positions. Finally, the proposal would eliminate the special limitations on changes to certain NSX by-laws and rules contained in Article XII of the NSX by-laws.

IV. Discussion

The Commission has reviewed the proposed rule change and finds that it is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.⁵ Specifically, the Commission finds that the proposed rule change furthers the objectives of Section 6(b)(1)⁶ of the Act, which requires the Exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members, with the Act and the rules of the Exchange. In addition, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁷ which requires, among other things, that the rules of a national securities 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 notes that NSX and CBOE have recently agreed to the Termination Agreement, which would amend and terminate certain aspects of their affiliation. The Commission also notes that NSX seeks to eliminate provisions of its by-laws and rules that were adopted to implement the terms of the original agreement of affiliation between NSX and CBOE.⁸ In particular, the Commission notes that the proposal would eliminate the CBOE Exerciser membership class. Under the proposal, the removal of the CBOE Exerciser membership class would be deferred until the conclusion of a ninety-day transition period. The

⁵ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f(b)(1).

⁷ 15 U.S.C. 78f(b)(5).

⁸ See supra note 4.

Commission believes that ninety days should be a reasonable period of time for interested CBOE members to purchase the requisite certificates of proprietary membership. In addition, the Commission notes that the proposal would remove special voting limitations on changes to its by-laws, and amend the provisions of its by-laws regarding the Special Nominating Committee. The Commission believes that these provisions are no longer necessary as a result of the amendments to NSX's affiliation with CBOE under the Termination Agreement.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Sections 6(b)(1)⁹ and 6(b)(5)¹⁰ of the Act.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (File No. SR-NSX-2004-12) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

J. Lynn Taylor
Assistant Secretary

⁹ 15 U.S.C. 78f(b)(1).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).