

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

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**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Membership Committee Jurisdiction Over Continuing Membership**

February 14, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on November 26, 1996, the Chicago Board Options Exchange, Inc. ("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 self-regulatory organization.<sup>3</sup> 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**

The Exchange proposes to amend CBOE Rule 3.4 to: (i) grant the Membership Committee, instead of the BCC, the power to decide whether to limit or condition the right of a person to continue as a member, or as a person associated with a member, when such person fails to meet any of the qualification requirements for membership or association after the membership or association has been approved, fails to meet any condition

placed by the Membership Committee on such membership or association, violates an agreement with the Exchange, or becomes subject to a statutory disqualification under the Act; and (ii) require a member or person associated with a member who is subject to a statutory disqualification to submit an application to the Membership Committee in order to continue as a member or as a person associated with a member.

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, the self-regulatory organization 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 IV below. The self-regulatory organization 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 grant to the CBOE's Membership Committee certain authority over persons who fail to meet conditions to their remaining as members, or who become subject to a statutory disqualification after becoming a member or person associated with a member. Presently this authority rests with the Exchange's BCC. The proposed rule change also requires a member or person associated with a member who is subject to a statutory disqualification and who wants to continue as a member or in association with a member to submit an application to that effect to the CBOE's Membership Committee.

CBOE Rule 3.4 (a) through (c) sets forth the reasons the CBOE's Membership Committee may deny or condition membership or a person's association with a member. However, the jurisdiction of the CBOE's Membership Committee currently applies only to applicants for membership or association with a member, not to existing members or associated persons. CBOE Rule 3.4(e) currently authorizes the Exchange's BCC

to take action against an existing member under Chapter XVII, "Discipline," of the CBOE's rules when any of these reasons for denying or conditioning membership (or association with a member) comes into existence. Under this authority, the Exchange's BCC may suspend or bar from membership an existing member for the same reasons a person applying for membership could be denied membership or be granted only conditional membership. For example, if an existing member becomes subject to a statutory disqualification under Sections 3(a)(39) and 15(b) under the Act, the CBOE's BCC may take action, pursuant to CBOE Rule 3.4(e), to discontinue that member's membership. In addition, Section 2.2 under the CBOE's Constitution, "Eligibility for Membership; Good Standing," provides that the good standing of a CBOE member may be suspended, terminated or otherwise withdrawn, as provided in the CBOE's Rules, if any of the conditions for approval cease to be maintained or the member violates any of its agreements with the Exchange or any of the provisions of the Constitution. Again, the CBOE's BCC currently would take action under Section 2.2 of the Exchange's Constitution against existing members or associated persons.

The CBOE believes it is more appropriate for the Exchange's Membership Committee to deal with membership related issues (whether those issues concern an applicant for membership or an already existing CBOE member), and for the Exchange's BCC to limit its activities to disciplinary matters involving allegations of specific rule violations. The Exchange believes that its Membership Committee is more familiar with the considerations that properly bear on decisions to deny or condition membership, and is best able to evaluate cases involving whether to continue or condition the membership of an existing member by referring to the standards it applies when evaluating applicants for membership. The Exchange's BCC may not be privy to membership applications that were denied by the CBOE's Membership Committee and the reasons for such denial. Furthermore, the CBOE's BCC may not be familiar with the factors considered by the Exchange's Membership Committee when acting on membership applications, or the types of conditions that may be imposed on applicants. In short, the Exchange believes that the present bifurcation of membership issues between the two committees could result in the CBOE's

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

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

<sup>3</sup> On February 12, 1997, the Exchange filed an amendment to the rule proposal. See Letter from Arthur Reinstein, Senior Attorney, CBOE, to Janice Mitnick, Attorney, Division of Market Regulation, Commission, dated February 12, 1997 ("Amendment No. 1"). Amendment No. 1 provides that failure to file an application notifying the Exchange of a statutory disqualification would be a factor to be considered by the CBOE's Membership Committee in making determinations with respect to the person's membership or association pursuant to CBOE Rule 3.4(e), instead of constituting a waiver of the individual's right of appeal. Further, Amendment No. 1 describes the procedures to be followed by the Exchange's Membership Committee in reviewing an application submitted pursuant to proposed Rule 3.4(f). Finally, Amendment No. 1 describes the composition of the CBOE's Business Conduct Committee ("BCC") and CBOE's Membership Committee.

BCC treating existing members who now fail to meet conditions of membership inconsistently with the way the CBOE's Membership Committee treats applicants for CBOE membership who are also subject to these same conditions.

The CBOE believes the same committee should make determinations about a person's fitness for CBOE membership whether that person is applying for CBOE membership or is an existing member whose ability to continue in membership is at issue. The proposed rule change would accomplish this. The CBOE states that, under the proposed rule change, the CBOE's Membership Committee may determine whether to limit or condition the right of a person to continue as a member or as a person associated with a member for the same reasons that the Exchange's BCC may presently take such action.

Pursuant to the proposed rule change, the CBOE's BCC will retain its powers to take action against existing members or associated persons under Section 2.2 of the Exchange's Constitution if the member or associated person violates any provision of the Exchange's Constitution or Rules. However, pursuant to the proposed rule change, the CBOE's BCC will no longer have the ability to take action pursuant to CBOE Rule 3.4(e) for the circumstances set forth in CBOE Rule 3.4(c).<sup>4</sup> Practically, the Exchange believes that this change will have little effect because the CBOE's BCC does not typically rely on CBOE Rule 3.4(e) to take action for the circumstances set forth in CBOE Rule 3.4(c). Instead, the practice of the CBOE's BCC is to take disciplinary action for specific rule violations. Most of the circumstances set forth in CBOE Rule 3.4(c) are covered by CBOE Rules 16.1, "Imposition of suspension," or 4.2, "Adherence to Law." Following the Exchange's present practice, the CBOE's BCC will continue to take disciplinary action based on CBOE Rule 4.2 and the Chairman of the Board or Chairman of the Executive Committee will continue to take action based on CBOE Rule 16.1.

The proposed rule change will also clarify that CBOE Rule 3.4(e) applies to persons associated with members as well as members. The other subsections

of CBOE Rule 3.4 refer to persons associated with members and it appears to be an oversight that subsection (e) does not refer to such persons. The Exchange has always interpreted Rule 3.4(e) to apply to associated persons.

Presently, under Chapter XIX, "Hearings and Review," of the CBOE's rules, if a person's application for membership is denied, that person may apply for a hearing before a panel of the Appeals Committee to review the Membership Committee's denial. The panel's decision may then be reviewed by the CBOE's Board of Directors pursuant to CBOE Rule 19.5, "Review." The proposed amendment will grant this same right of review to an existing member or person associated with a member and will reference this right in new paragraph (g) to CBOE Rule 3.4. New paragraph (g) to CBOE Rule 3.4 also provides that no determination of the Membership Committee to discontinue or condition a person's membership or association with a member pursuant to CBOE Rule 3.4(e) shall take effect until the review procedures under Chapter XIX have been exhausted or the time for review has expired.

The proposed rule change will also add a paragraph (f) to CBOE Rule 3.4 requiring a member or person associated with a member who becomes subject to a statutory disqualification to submit an application to the Exchange's Membership Committee within 30 days of becoming subject to a statutory disqualification if the member or person associated with a member wants to continue in their membership or association with a member.<sup>5</sup> Paragraph (b) of Rule 19h-1 under the Act requires a self-regulatory organization to file a preliminary notice with the Commission promptly after it receives an application for admission to, or continuance in, membership or association with a member, notwithstanding a statutory disqualification. In order to permit the Exchange to file the required preliminary notice in respect of existing members and associated persons, proposed paragraph (f) of CBOE Rule 3.4 requires the statutorily disqualified member or associated person to submit a

formal application to the Exchange requesting permission to continue in membership or association. The application would include the permission to continue in membership or association. The application would include the information the Exchange needs from the member or associated person in order to complete the Rule 19h-1 preliminary notice. The application would also inform the Exchange that it needs to devote the resources necessary to make a decision regarding whether to continue the membership or association of this statutorily disqualified person or entity.

Pursuant to proposed paragraph (f) of CBOE Rule 3.4, absent extenuating circumstances, if the member or associated person who is subject to a statutory disqualification fails to file an application with the CBOE's Membership Committee seeking to continue in Exchange membership or association, the Exchange will consider such failure as a factor to be considered by the Membership Committee in making determinations with respect to the person's membership or association pursuant to Rule 3.4(e).<sup>6</sup>

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with and furthers the objectives of Section 6(b) (6) and (7) of the Act, in that it is designed to protect investors and the public interest by providing appropriate standards of qualification for membership and association with members, and procedures intended to assure the consistent application of these standards.

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

The Exchange believes that the proposed rule change will not impose any burden on competition.

### *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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and

<sup>4</sup> Under CBOE Rule 3.4(c), the CBOE's Membership Committee may deny or condition membership or prevent or condition a person from becoming an associated person if the applicant has a negative net worth or other financial difficulties, is unable to satisfactorily demonstrate a capacity to adhere to all applicable CBOE, Commission, Options Clearing Corporation, and Federal Reserve Board policies and rules, would bring the CBOE into disrepute, or for such other cause as the CBOE's Membership Committee may reasonably decide.

<sup>5</sup> See Amendment No. 1 *supra* note 3. Procedures to be followed by the CBOE's Membership Committee in considering an application filed pursuant to CBOE Rule 3.4(f) to continue as a member or associated person after becoming subject to a statutory disqualification will be the same procedures that are followed currently by the CBOE's Membership Committee when it reviews an application from a person subject to a statutory disqualification who is applying for exchange membership or association with an Exchange member. These procedures are generally set forth in Exchange Regulatory Circular RG95-93.

<sup>6</sup> See Amendment No. 1, *supra* note 3.

publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-96-73 and should be submitted by March 18, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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### **Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to the Policy of the CBOE Relating to Information Obtained Pursuant to the SEC's Memorandum of Understanding With the CONSOB**

February 19, 1997.

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> notice is hereby given that on December

17, 1996, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change is described in Items I and II 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 and to grant accelerated approval of the proposed rule change.

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

The CBOE is submitting this rule filing to adopt an official policy concerning the circumstances and conditions under which the Exchange, in order to carry out its market surveillance and enforcement functions for derivative products containing Italian component securities, may obtain access to information regarding activity on the Italian securities markets obtained by the SEC pursuant to the Commission's Memorandum of Understanding ("MOU") with the Commissione Nazionale per le Società e la Borsa ("CONSOB"). The text of the proposed rule change is available at the Office of the Secretary, the 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, the 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 IV below. The 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*

The CBOE does not have a surveillance sharing agreement with the Milan Exchange, which is an unincorporated association and is not able under Italian law to enter into such an arrangement. Therefore, the purpose of the proposed rule change is to enable the CBOE to carry out its market surveillance and enforcement functions for derivative products containing Italian component securities by seeking the necessary information about activity on the Italian securities markets from

the SEC per the latter's MOU with the CONSOB. The Exchange's proposed policy details the circumstances and conditions under which the Exchange may obtain access to such information from the SEC. By adopting this policy, therefore, the Exchange believes it will be in a position to list derivative products containing Italian component securities because it will be able to have access to information on the underlying securities which it may need for enforcement or market surveillance purposes.

The Exchange's proposed policy provides that the Exchange will advise the SEC of information it needs regarding activity on the Italian securities markets for market surveillance and enforcement purposes. The SEC, in turn, may request the CONSOB's assistance, pursuant to the MOU, in gaining access to such information. The Exchange will use such information it may receive from the SEC only for the purposes of conducting market surveillance and enforcement proceedings. The Exchange will limit distribution of such information to officers and directors of the Exchange and other employees directly responsible for conducting market surveillance and enforcement proceedings relating to the matter in connection with which the SEC provided the information to the CBOE. The Exchange also will undertake to maintain the confidentiality of the information and to take appropriate disciplinary action in the event it learns of a breach of such confidentiality, including referral to the SEC for any action the SEC deems necessary or appropriate.

By adopting a policy that provides access to information on the underlying securities for market surveillance and enforcement purposes, the Exchange will be able to list options and other derivative products containing Italian component securities, provided that all other applicable product listing standards are met.<sup>3</sup> Therefore, the Exchange believes that the proposed rule change could potentially provide investors with the opportunity to invest in such products and hedge their exposure to the Italian securities market. The Exchange also believes that the proposed rule change, therefore, is consistent with and furthers the objectives of Section 6(b)(5) of the Act, in that it is designed to perfect the mechanisms of a free and open market

<sup>3</sup> This filing only addresses trading requirements relating to necessary surveillance sharing procedures.

<sup>7</sup> 17 CFR 200.30-3(a)(12).

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

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