

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46981; File No. SR-CBOE-2001-59]

### Self-Regulatory Organizations; Order Granting Approval to the Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Amending CBOE Disciplinary Rules 17.4, 17.9 and 17.10

December 11, 2002.

#### I. Introduction

On December 6, 2001, the Chicago Board Options Exchange, Inc. ("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"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend provisions of its disciplinary rules. On December 17, 2001, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on January 3, 2002.<sup>4</sup> The Commission received no comments on the proposal and Amendment No. 1. On May 13, 2002, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>5</sup> On October 9, 2002, the Exchange filed Amendment No. 3 to the proposed rule change.<sup>6</sup> The Commission

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

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

<sup>3</sup> See letter from Christopher R. Hill, Attorney II, Office of Enforcement, Legal Division, CBOE, to Sapna C. Patel, Attorney, Division of Market Regulation ("Division"), Commission, dated December 13, 2001 ("Amendment No. 1").

<sup>4</sup> Securities Exchange Act Release No. 45191 (December 26, 2001), 67 FR 378.

<sup>5</sup> See letter from Nancy Nielsen, Director of Arbitration and Assistant Secretary, CBOE, to Nancy Sanow, Assistant Director, Division, Commission, dated May 10, 2002 ("Amendment No. 2"). In Amendment No. 2, the CBOE deleted proposed CBOE Rule 17.15, which would have governed ex parte communications with any member of the CBOE Board of Directors ("Board"), and amended CBOE Rule 17.4 to incorporate the Board into the prohibition against ex parte communications with the Exchange's Business Conduct Committee ("BCC"). In addition, Amendment No. 2 proposes to add Interpretations .02 and .03 to CBOE Rule 17.4.

<sup>6</sup> See letter from Christopher R. Hill, Attorney II, Office of Enforcement, Legal Division, CBOE, to Nancy Sanow, Assistant Director, Division, Commission, dated October 8, 2002 ("Amendment No. 3"). In Amendment No. 3, the CBOE proposed to clarify in Interpretation .03 that a person refusing an ex parte communication must notify Exchange regulatory staff about such ex parte communication and how he or she responded to it, and that the Exchange regulatory staff must memorialize such

is approving the proposed rule change and Amendment No. 1, and is publishing notice of, and granting accelerated approval to, Amendment Nos. 2 and 3 to the proposed rule change.

Below is the text of the proposed rule change, as amended. Proposed new language is *italicized*, and proposed deletions are in brackets.

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Chicago Board Options Exchange, Incorporated Rules

Chapter XVII—Discipline

Rule 17.4. Charges

(a) No Change.

(b) No Change.

(c) No Change.

(d) No member or person associated with a member shall make or knowingly cause to be made an ex parte communication with any member of the Business Conduct Committee or Board concerning the merits of any matter pending under Chapter XVII of the Rules. No member of the Business Conduct Committee or Board shall make or knowingly cause to be made an ex parte communication with any member or any person associated with a member concerning the merits of any matter pending under Chapter XVII of the Rules.

\* \* \* \* \*

\* \* \* Interpretations and Policies

.01 No Change.

.02 *No violation of Rule 17.4(d) shall be deemed to occur if the ex parte communication deals solely with procedural matters rather than the merits of the investigation or proceeding.*

.03 *No person shall be deemed to violate Rule 17.4(d) if the person refuses an attempted communication concerning the merits of an investigation or proceeding as soon as it becomes apparent that the communication concerns the merits. In order for this Interpretation .03 to apply, the person refusing the attempted communication must promptly notify Exchange regulatory staff about the attempted communication and how the person responded to it. Exchange regulatory staff shall memorialize this*

information of the attempted communication in the regulatory record of the investigation or disciplinary proceeding. In addition, the CBOE provided the following examples of what it would consider "solely procedural matters" for purposes of proposed Interpretation .02: "the time, place, or manner of events in the disciplinary process, or the procedural requirements set forth in the Exchange's rules as they apply to the disciplinary proceedings."

information in the regulatory record of the investigation or disciplinary hearing.

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Rule 17.9. Decision

Following a hearing conducted pursuant to Rule 17.6 of this Chapter, the Panel shall issue a decision in writing, based solely on the record, determining whether the Respondent has committed a violation and imposing the sanction, if any, therefor. Where the Panel is not composed of at least a majority of the members of the Business Conduct Committee, its determination shall be automatically reviewed by a majority of the Committee, which may affirm, reverse or modify in whole or in part or may remand the matter for additional findings or supplemental proceedings. Such modification may include an increase or decrease of the sanction. The decision shall include a statement of findings and conclusions, with the reasons therefor, upon all material issues presented on the record. Where a sanction is imposed, the decision shall include a statement specifying the acts or practices in which the Respondent has been found to have engaged and setting forth the specific provisions of the Securities Exchange Act of 1934, as amended, rules and regulations promulgated thereunder, constitutional provisions, by-laws, rules, interpretations or resolutions of the Exchange of which the acts are deemed to be in violation. The Respondent and the Office of Enforcement shall be promptly sent a copy of the decision. After Board review pursuant to Rule 17.10, or the time for such review has expired, the decision will be considered final, and the Exchange shall publish a summary of the decision in the Exchange Bulletin.

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Rule 17.10. Review

(a)

(1) Petition. Both t[T]he Respondent and the Office of Enforcement shall have 15 days after service of notice of any [a] decision made pursuant to Rule 17.9 of this Chapter to petition for review of the decision by filing a copy of the petition with the Secretary of the Exchange ("Secretary") and with all other parties to the hearing [the Exchange's Office of Enforcement]. Such petition shall be in writing and shall specify the findings and conclusions to which exceptions are taken together with reasons for such exceptions. Any objections to a decision not specified by written exception shall be considered to have been abandoned.

(2) Written Submissions. Within 15 days after a [Respondent's] petition for review has been filed with the Secretary of the Exchange pursuant to paragraph (a)(1) of this Rule, *the other parties to the hearing* [Exchange staff] may each submit to the Secretary a written response to the petition. A copy of the response must be served upon the *petitioner* [Respondent]. *The petitioner* [A Respondent] has 15 days from the service of the response to file a reply with the Secretary and the *other parties to the hearing* [Office of Enforcement].

(b) Conduct of Review. The review shall be conducted by the Board or a committee of the Board composed of at least three Directors whose decision must be ratified by the Board. Any Director who participated in a matter before the Business Conduct or other Committee may not participate in any review of that matter by the Board. Unless the Board shall decide to open the record for the introduction of evidence or to hear argument, such review shall be based solely upon the record and the written exceptions filed by the parties. New issues may be raised by the Board; *the parties to the hearing* [Respondents] shall be given notice of and an opportunity to address any such new issues. The Board may affirm, reverse or modify, in whole or in part, the decision of the Business Conduct Committee. Such modification may include an increase or decrease of the sanction. The decision of the Board shall be in writing, shall be promptly served on the Respondent *and the Office of Enforcement*, and shall be final.

(c) Review on Motion of Board. The Board may on its own initiative order review of a decision made pursuant to Rule 17.7 or 17.9 of this Chapter within 30 days after notice of the decision has been served on the Respondent *and the Office of Enforcement*. Such review shall be conducted in accordance with the procedure set forth in paragraph (b) of this Rule.

(d) No change.

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## II. Description of the Proposal

### A. Ex Parte Communications with Exchange Board Members Prohibited

Exchange Rule 17.4(d) prohibits members or persons associated with members from making or causing ex parte communications with any member of the BBC concerning the merits of any matter pending under the disciplinary rules of the Exchange. This prohibition is to eliminate the potential that such communications might somehow influence the outcome of an

investigation or enforcement matter. The proposed rule change would amend Exchange Rule 17.4(d) to also forbid ex parte communications with members of the Board. The Exchange represents that such communications are already prohibited by some of the other self-regulatory organizations ("SROs").<sup>7</sup>

The proposed rule change would also add two new Interpretations to clarify the application of the amended Exchange Rule 17.4(d). Proposed Interpretation .02 addresses the current language of Exchange Rule 17.4(d), which permits ex parte communications that do not "concern the merits." Proposed Interpretation .02 distinguishes permissible ex parte communications from those "concerning the merits" by specifying that the only permissible ex parte communications are those that deal "solely" with procedural matters. The Exchange considers examples of "solely procedural matters" to include the following: "the time, place, or manner of events in the disciplinary process, or the procedural requirements set forth in the Exchange's rules as they apply to the disciplinary proceedings."<sup>8</sup>

Proposed Interpretation .03 is intended to provide workable guidelines for Board and BCC members, particularly those who work on the Exchange trading floor. In such positions, these Board and BCC members are subject to the possibility that a member or associated person involved in an investigation or disciplinary proceeding may approach them and launch into a conversation or other communication concerning the merits of their disciplinary case before the Board or BCC member can stop them. The Exchange believes it would be unfair in such circumstances to subject the Board or BCC member to disciplinary action for violation of Exchange Rule 17.4(d) if the violation of the Rule is caused by the unpredictable and uncontrollable actions of a third party. At the same time, the Exchange believes that Board or BCC members in such circumstances remain responsible for adhering to Exchange Rule 17.4(d) and encouraging members and

<sup>7</sup> See American Stock Exchange LLC Exchange Disciplinary Proceedings Rule 11(a); National Association of Securities Dealers, Inc. ("NASD") Rule 9143(a); and Pacific Exchange, Inc. Rule 10.3(a).

<sup>8</sup> See Amendment No. 3, *supra* note 6. The Exchange represents that by "manner of events in a disciplinary process," it means the sequence of events in the disciplinary process. Telephone conversation between Christopher R. Hill, Attorney II, Office of Enforcement, Legal Division, CBOE, and Sapna C. Patel, Attorney, Division, Commission, on December 5, 2002.

associated persons to do likewise. To balance these concerns, proposed Interpretation .03 clarifies that, in such circumstances, Board or BCC members will not be deemed to have violated Exchange Rule 17.4(d) so long as they "refuse the communication" (e.g., stop the conversation, stop reading the e-mail or letter, etc.) as soon as it becomes apparent that the communication concerns the merits of the case. In addition, the Exchange proposes to require that a person refusing an ex parte communication notify Exchange regulatory staff about such ex parte communication and how he or she responded to it, and also requires that the Exchange regulatory staff memorialize such information of the attempted communication in the regulatory record of the investigation or disciplinary proceeding.<sup>9</sup> The Exchange represents that copies of the attempted communication will be given to all of the parties involved in the proceeding.<sup>10</sup>

### B. Exchange Office of Enforcement's Right To Appeal

Exchange Rule 17.10(a) permits a respondent in a disciplinary matter to appeal a decision of the BCC to the Board, but does not grant the Exchange's Office of Enforcement ("OOE") a similar right of appeal. The proposed rule change would permit the Exchange's OOE to appeal factual findings that the OOE thinks may have been in error, as well as to appeal disciplinary sanctions that the OOE deems insufficient. The Exchange represents that such appeals are already authorized at other SROs.<sup>11</sup> Therefore, the Exchange proposes to amend Exchange Rules 17.9 and 17.10 to give the OOE and the Respondent equivalent rights in the appellate process.

## III. Discussion

The Commission has carefully reviewed the proposed rule change, as amended, and finds that it is consistent with the Act and the rules and regulations promulgated thereunder applicable to a national securities exchange and, in particular, with the requirements of section 6(b) of the Act.<sup>12</sup> Specifically, the Commission

<sup>9</sup> See Amendment No. 3, *supra* note 6.

<sup>10</sup> Telephone conversation between Christopher R. Hill, Attorney II, Office of Enforcement, Legal Division, CBOE, and Kathy A. England, Assistant Director, and Sapna C. Patel, Attorney, Division, Commission, on December 5, 2002.

<sup>11</sup> See New York Stock Exchange, Inc. Rule 476(f); NASD Rule 9311; and Securities Exchange Act Release No. 43554 (November 14, 2001), 65 FR 69975 (November 21, 2001) (File No. SR-Amex-00-22).

<sup>12</sup> 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rule's

finds that the proposed rule change, as amended, is consistent with section 6(b)(5) of the Act<sup>13</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest. In addition, the Commission finds that the proposed rule change, as amended, is consistent with sections 6(b)(1) and 6(b)(7) of the Act<sup>14</sup> in that it requires compliance by the Exchange members and persons associated with its members with the Act, the rules and regulations thereunder, and Exchange rules; and provides a fair procedure for the disciplining of Exchange members.

The Commission believes that the proposed rule change, as amended, should limit ex parte communications in the disciplinary process, thereby providing a safeguard against influence over the outcome of a disciplinary proceeding and eliminating the appearance of unfairness. The Commission notes that the Exchange currently prohibits ex parte communications between persons involved in disciplinary proceedings and the Exchange's BCC. Extending the prohibition to Board members is consistent with practices on other SROs.<sup>15</sup>

The Commission believes that proposed Interpretations .02 and .03 to the proposed rule change should provide objective criteria and guidance regarding the application of the proposed rule change, as amended. The Commission notes that proposed Interpretation .02 excludes from the prohibition against ex parte communications any ex parte communications dealing solely with procedural matters. The Commission further notes that the Exchange has provided examples of what it considers "solely procedural matters." The Commission believes that proposed Interpretation .03 strikes the right balance permitting persons who refuse an attempted ex parte communication to avoid violating the rule, provided that they report such attempted communication and their responses to such communications to Exchange regulatory staff. The proposed Interpretation would also require Exchange regulatory staff to keep a record of the attempted ex parte communication in the regulatory record

of the investigation or disciplinary proceeding. In addition, the Commission notes that the Exchange has represented that it will give copies of the attempted ex parte communication to all of the parties involved in the proceeding.<sup>16</sup>

Furthermore, the Commission believes that allowing the Exchange's OOE to appeal a decision of the BCC to the Board regarding factual findings that the OOE believes may have been in error or disciplinary sanctions that it finds insufficient, is consistent with practices on other SROs.<sup>17</sup>

In addition, the Commission finds good cause for approving Amendment Nos. 2 and 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 2 deletes proposed CBOE Rule 17.15 and amends CBOE Rule 17.4 to incorporate the Board into the prohibition against ex parte communications with the BCC. The Commission believes this change is not substantively different from the proposal, as published. In addition, it makes sense for the Board to be subject to the same limitations that the BCC is subject to. As discussed more fully above, Amendment No. 3 provides clarity to proposed rule change by requiring persons to report attempted communications, and by requiring Exchange regulatory staff to memorialize the communications. In addition, Amendment No. 3 provides examples of what the Exchange would consider "solely procedural matters" for purposes of proposed Interpretation .02. The Commission, therefore, finds good cause to approve Amendment Nos. 2 and 3 to the proposed rule change on an accelerated basis.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether the Amendment Nos. 2 and 3 to the proposed rule change are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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-2001-59 and should be submitted by January 7, 2003.

#### V. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-CBOE-2001-59) and Amendment No. 1 are hereby approved, and that Amendment Nos. 2 and 3 to the proposed rule change are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46975; File No. SR-CME-2002-02]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change by the Chicago Mercantile Exchange Relating to Listing Standards for Security Futures Products

December 9, 2002.

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on October 28, 2002, Chicago Mercantile Exchange ("CME" or "the Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by CME.

On November 1, 2002, CME filed an amendment to the proposed rule change to clarify the proposed rules.<sup>3</sup> On

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

<sup>3</sup> See letter from Richard J. McDonald, Managing Director, Product Development, CME, to Office of Market Supervision, Division of Market Regulation,

impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 15 U.S.C. 78f(b)(1); and 15 U.S.C. 78f(b)(7).

<sup>15</sup> See, e.g., supra note 7.

<sup>16</sup> Telephone conversation between Christopher R. Hill, Attorney II, Office of Enforcement, Legal Division, CBOE, and Kathy A. England, Assistant Director, and Sapna C. Patel, Attorney, Division, Commission, on December 5, 2002.

<sup>17</sup> See, e.g., supra note 11.