

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Margaret H. McFarland, Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48540; File No. SR-CBOE-2003-31]

Self-Regulatory Organizations; Notice of Filing and Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Audit Committee Requirements Applicable to Companies Listing Non-Option Securities

September 25, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 19b-4 thereunder, notice is hereby given that on July 11, 2002, 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 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 amend certain non-option listing rules of the Exchange in response to the adoption of Rule 10A-3 of the Exchange Act. Below is the text of the proposed rule change. Proposed new language is italicized; deletions are in brackets.

Rule 31.7 Securities of Foreign Issuers

(1) No change.

(2) The Exchange will consider the law, and commercial and business practice of the applicant's domicile in evaluating (A) the election and composition of its Board of Directors, to the extent such law, and commercial and business practice with respect to the election and composition of its Board of Directors is consistent with the federal securities laws, including, but not limited to, Rule 10A-3 of the Securities Exchange Act of 1934, as

amended, (B) shareholder approval and quorum requirements for meetings, and (C) the issuance of quarterly earnings statements.

(3)-(5) No change.

\* \* \* \* \*

Rule 31.10 Independent Directors

The Exchange requires an issuer to have at least two independent directors. For purposes of this section, "independent director" shall mean a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The issuer shall maintain an audit committee (i) composed of such independent directors[,] and (ii) that complies with the listing standards set forth in Rule 10A-3 of the Securities Exchange Act of 1934, as amended ("Exchange Act"). If a member of the audit committee ceases to be independent in accordance with the requirements of Exchange Act Rule 10A-3 for reasons outside the member's reasonable control, that person, with written notice to the Exchange, may remain an audit committee member of the listed issuer until the earlier of the next annual shareholders meeting of the listed issuer or one year from the occurrence of the event that caused the member to be no longer independent.

\* \* \* \* \*

Rule 31.94 Suspension and Delisting Policies

(A)-(I) No change.

\* \* \* Interpretations and Policies

.01 With respect to an issuer that does not comply with the requirements of Rule 10A-3 of the Securities Exchange Act of 1934, as amended, as set forth in Rule 31.10, the Exchange shall remove from listing the securities of such issuer.

\* \* \* \* \*

Rule 31.96 Notices to Exchange

(A) No change.

(B) Changes in Officers or Directors.

A listed company is required to notify the Exchange promptly (and confirm in writing) (i) of any changes of officers or directors and (ii) after an executive officer of the listed company becomes aware of any material noncompliance by the listed company with the requirements of Rule 10A-3 of the Securities Exchange Act of 1934, as amended.

(C)-(G) No change.

\* \* \* \* \*

Rule 31.97 [Reserved for additional original listing standards.]

\* \* \* \* \*

Forms for Listing

\* \* \* \* \*

Form 1

\* \* \* \* \*

Listing Agreement

(the "Company"), in consideration of the listing of its securities, hereby agrees with the Chicago Board Options Exchange, Incorporated (the "Exchange"), that it will:

1. Promptly notify the Exchange of the following:

(a) changes in the general character or nature of its business, its principal executive officers, directors, its independent public accountants, its transfer agent or registrar and material noncompliance by the listed company with Rule 10A-3 of the Securities Exchange Act of 1934, as amended ("Exchange Act"), after an executive officer becomes aware of such noncompliance;

(b)-(k) No change.

(2)-(27) No change.

(28) Comply with Exchange rules, policies and procedures as in effect and as they may be amended from time to time and with the requirements of Exchange Act Rule 10A-3.

\* \* \* \* \*

II. Self-Regulatory Organization's Statement of the Purpose of, and the 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 IV below. 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

Exchange Act Rule 10A-3(a)(1) provides that the "rules of each national securities exchange registered pursuant to section 6 of the [Exchange] Act (15 U.S.C. 78f) must, in accordance with the provisions of [Exchange Act Rule 10A-3], prohibit the initial or continued listing of any security of an issuer that

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 17 CFR 240.10A-3. See Securities Exchange Act Release No. 47137 (January 8, 2003) 68 FR \_\_\_\_\_ (date).

is not in compliance with the requirements of any portion of paragraph (b) or (c) of [Exchange Act Rule 10A-3].” Exchange Act Rule 10A-3(b) contains new requirements for an issuer’s audit committee and Exchange Act Rule 10A-3(c) provides general exemptions from the requirements of Exchange Act Rule 10A-3. Exchange Act Rule 10A-3(a)(5)(ii) requires CBOE to propose new rules or rule amendments that comply with Exchange Act Rule 10A-3 no later than July 15, 2003.

CBOE Rules 31.5–31.16 contain the criteria for the original listing of an applicant’s non-option securities on CBOE. In particular, CBOE Rule 31.7 provides that with respect to foreign issuers, CBOE will consider the law, and commercial and business practice of the foreign issuer’s domicile in evaluating the election and composition of the foreign issuer’s Board of Directors. CBOE proposes to add a proviso that makes clear CBOE’s intention to consider the law, and commercial and business practice of the foreign issuer’s domicile only if such law and practices are consistent with federal securities laws, including Exchange Act Rule 10A-3. CBOE also proposes to amend another original listing criterion, CBOE Rule 31.10, which currently provides in part that “the issuer shall maintain an audit committee composed of \* \* \* independent directors.” To comply with Exchange Act Rule 10A-3, CBOE proposes to amend the quoted language above in CBOE Rule 31.10 by incorporating by reference the listing standards set forth in Exchange Act Rule 10A-3. Specifically, the proposed language in CBOE Rule 31.10 provides in part that “the issuer shall maintain an audit committee (i) composed of such independent directors and (ii) that complies with the listing standards set forth in Rule 10A-3 of the Securities Exchange Act of 1934, as amended.” CBOE proposes to amend the listing agreement on CBOE Form 1 so that it conforms to the proposed language set forth above in CBOE Rule 31.10. Proposed CBOE Rule 31.10 also incorporates the language set forth in Exchange Act Rule 10A-3(a)(3) to satisfy the requirement that CBOE provides appropriate procedures for an issuer to have an opportunity to cure any defects that would be the basis for the prohibition of listing the securities of such issuer under Exchange Act Rule 10A-3(a).

CBOE proposes to add an interpretation to CBOE Rule 31.94 that revises one of CBOE’s delisting policies in order to comply with Exchange Act

Rule 10A-3. The revision is required because CBOE Rule 31.94(B)(d) currently permits CBOE’s Board of Directors to use its discretion in deciding whether to delist an issuer’s non-option securities from trading when, in the opinion of CBOE, “the issuer has failed to comply with its listing agreements” with CBOE. Exchange Act Rule 10A-3(a)(1) makes clear that an exchange may not use discretion in deciding whether to delist a non-option security of an issuer that does not comply with Exchange Act Rule 10A-3.

Exchange Act Rule 10A-3(a)(4) provides that the rules required by Exchange Act Rule 10A-3(a)(1) and (2) must include a requirement that a listed issuer must notify CBOE promptly after an executive officer of the listed issuer becomes aware of any material noncompliance by the listed issuer with the requirements of Exchange Act Rule 10A-3. Proposed Rule 31.96(B) and the listing agreement on CBOE Form 1 are amended to reflect this requirement.

The proposed rule change reserves a new rule, proposed CBOE Rule 31.97, to incorporate additional and enhanced original listing standards for the listing of non-option securities on the Exchange. CBOE understands that the National Association of Securities Dealers, Inc. (“NASD”) and the New York Stock Exchange, Inc. (“NYSE”) have filed rule proposals with the Commission that strengthen their listing standards by enhancing corporate governance requirements for listed entities.<sup>4</sup> Following the Commission’s approval of these rule proposals, CBOE intends to submit a rule proposal to the Commission to adopt substantially similar changes to CBOE’s original listing rules. For example, consistent with the listing standards that are adopted by NYSE and/or NASD, CBOE intends to revise its original listing rules to, among other things, further address (i) independent director representation on the issuer’s Board of Directors; (ii) independent director representation on the issuer’s nominating and compensation committees; (iii) shareholder approval requirements of equity-compensation plans, (iv) corporate governance guidelines of issuers; (v) issuer codes of business conduct and ethics; and (vi) the definition of “independent” that is

<sup>4</sup> See Securities Exchange Act Release No. 34-47516 (March 17, 2003), 68 FR 14451 (March 25, 2003) (noticing SR-NASD-2002-141) and Securities Exchange Act Release No. 34-47672 (April 11, 2003), 68 FR 19051 (April 17, 2003) (noticing SR-NYSE-2002-33).

currently provided for in CBOE Rule 31.10.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Exchange Act,<sup>5</sup> in general, and furthers the objectives of Sections 6(b)(5) of the Exchange Act,<sup>6</sup> in particular, in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.

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

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

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

(A) By order approve such 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, including whether the proposed rule change is 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

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).

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 Room. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to File No. SR-CBOE-2003-31 and should be submitted by October 23, 2003.

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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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48538; File No. SR-PCX-2002-01]

### Self Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 3 to the Proposed Rule Change by the Pacific Exchange, Inc., Relating to Procedures for Obvious Errors in Options Transactions

September 25, 2003.

#### I. Introduction

On January 3, 2002, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "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 adopt an obvious error rule for options transactions. On July 28, 2003, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On August 8, 2003, the Exchange submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> The proposed rule change, as

amended, was published for comment in the **Federal Register** on August 22, 2003.<sup>5</sup> The Commission did not receive any comments on the proposed rule change. On September 16, 2003, the PCX filed Amendment No. 3 to the proposed rule change.<sup>6</sup> This order approves the proposed rule change, as amended, grants accelerated approval to Amendment No. 3, and solicits comments from interested persons on that amendment.

#### II. Discussion and Commission Findings

The Commission has reviewed carefully the proposed rule change and finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>7</sup> In particular, the Commission finds that the proposed rule change is consistent with section 6(b)(5)<sup>8</sup> of the Act, which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.<sup>9</sup>

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether such an "obvious error" has occurred should be based on specific and objective criteria and subject to

Assistant Director, Division, Commission, dated August 7, 2003 ("Amendment No. 2"). Amendment No. 2 supersedes and replaces the proposed rule change and Amendment No. 1 in their entirety.

<sup>5</sup> See Securities Exchange Act Release No. 48342 (August 14, 2003), 68 FR 50820 (August 22, 2003) ("Notice").

<sup>6</sup> See Letter from Mai S. Shiver, Senior Attorney, Regulatory Policy, Exchange, to Nancy J. Sanow, Assistant Director, Division, Commission, dated September 15, 2003 ("Amendment No. 3"). In Amendment No. 3, the Exchange amended proposed PCX Rule 6.87(g)(2)(E) to clarify a provision relating to the determination of an obvious price error and amended proposed PCX Rule 6.87(g)(2)(G) to clarify the definition of "parity."

<sup>7</sup> For a description of the proposed rule change, see Notice, *supra*, n.4.

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

specific and objective procedures. The Commission believes that the PCX's proposed obvious error rule establishes specific and objective criteria for determining when a trade is an "obvious error." The Commission also believes that the proposal establishes specific and objective procedures governing the adjustment or nullification of such trade. In addition, the Commission notes that several provisions of the PCX obvious error rule proposal, as amended, are substantially similar to proposed rule changes submitted by the Chicago Board Options Exchange, Inc. and International Securities Exchange, Inc., which the Commission has approved.<sup>10</sup>

The Commission finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 3 does not make any substantive changes to the proposed rule text. It simply clarifies the determination of an obvious price error and the definition of a transaction executed below parity. Therefore, the Commission believes that granting accelerated approval of Amendment No. 3 is appropriate and consistent with section 6(b)(5)<sup>11</sup> and section 19(b)<sup>12</sup> of the Act.

#### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether Amendment No. 3 is 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 proposal that are filed with the Commission, and all written communications relating to the proposal 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.

<sup>10</sup> See Securities Exchange Act Release No. 47628 (April 3, 2003), 68 FR 17697 (April 10, 2003) (SR-CBOE-00-55); Securities Exchange Act Release No. 48097 (June 26, 2003), 68 FR 39604 (July 2, 2003) (SR-ISE-2003-10).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> 15 U.S.C. 78s(b).

<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.

<sup>3</sup> See Letter from Mai S. Shiver, Senior Attorney, Regulatory Policy, Exchange, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 25, 2003 ("Amendment No. 1"). Amendment No. 1 supersedes and replaces the proposed rule change in its entirety.

<sup>4</sup> See Letter from Mai S. Shiver, Senior Attorney, Regulatory Policy, Exchange, to Nancy J. Sanow,