

All submissions should refer to File Number SR-CBOE-2003-39 and should be submitted on or before August 5, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49995; File No. SR-CBOE-2004-28]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 thereto by the Chicago Board Options Exchange, Incorporated, Relating to Enhanced Corporate Governance Requirements for Listed Companies

July 9, 2004.

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 May 6, 2004, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I and II below, which Items have been prepared by the CBOE. On June 24, 2004, and July 9, 2004, the CBOE filed Amendment Nos. 1<sup>3</sup> and 2,<sup>4</sup> respectively, to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal on an accelerated basis.

<sup>11</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 David Doherty, Attorney, Legal Division, CBOE, to Ira Brandriss, Assistant Director, Division of Market Regulation ("Division"), Commission, dated June 23, 2004 ("Amendment No. 1"). The changes proposed in Amendment No. 1 have been incorporated into the proposal as set forth below.

<sup>4</sup> See letter from David Doherty, Attorney, Legal Division, CBOE, to Cyndi N. Rodriguez, Special Counsel, Division, Commission, dated July 9, 2004 ("Amendment No. 2"). Amendment No. 2 was a technical amendment and is not subject to notice and comment.

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

The CBOE proposes to amend its non-option listing standards to enhance the Exchange's corporate governance requirements applicable to listed companies. The text of the proposed rule filing, as amended, is set forth below. Additions are in italics; deletions are in brackets.

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Chicago Board Options Exchange, Incorporated

Rules

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Chapter XXXI

\* \* \* \* \*

Approval of Securities for Original Listing

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Rule 31.7 Securities of Foreign Issuers

(1) No change.  
(2) The Exchange will consider the law, and *generally accepted* commercial and business practice of the [applicant's] *foreign issuer's* domicile in evaluating (A) the election and composition of its Board of Directors, to the extent such law, and *generally accepted* 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, *Exchange Act* 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. *A foreign issuer that receives an exemption under this Rule 31.7(2) shall disclose in its annual reports filed with the Securities and Exchange Commission each requirement from which it is exempted and describe the practice of the foreign issuer's domicile, if any, followed by the issuer in lieu of such requirements. In addition, a foreign issuer making its initial public offering or first United States listing on the Exchange shall disclose any such exemptions in its registration statement.*  
(3)-(5) No change.

\* \* \* Interpretations and Policies

01. *A foreign private issuer listed on the Exchange may obtain exemptions from the corporate governance requirements described in Rule 31.7(2) that are consistent with the federal securities laws, including, but not limited to, Exchange Act Rule 10A-3, if*

*such requirements would require the issuer to do anything contrary to the law, and generally accepted commercial and business practice of the foreign issuer's domicile. Issuers may request exemptions under this rule by submitting a letter from their home country counsel briefly describing the law, and generally accepted commercial and business practice of the home country. In the interest of transparency, the rule requires a foreign issuer to disclose the receipt of a corporate governance exemption in the issuer's annual filings with the Securities and Exchange Commission (typically Form 20-F or 40-F) and at the time of the issuer's original listing in the United States, if that listing is on the Exchange, in its registration statement (typically Form F-1, 20-F, or 40-F). The disclosure should include a brief statement of what alternative measures, if any, the issuer has taken in lieu of the corporate governance requirement(s) from which it was exempted. For example, the issuer might state that it complies with the relevant standards of its domicile.*

\* \* \* \* \*

Rule 31.9 Conflicts of Interest

Applicants will be asked to eliminate material conflicts of interest between officers, directors or principal shareholders and the applicant issuer prior to approval of the listing. Each issuer shall conduct an appropriate review of all related party transactions for *potential conflict of interest situations* on an ongoing basis and [shall use] *all such transactions must be approved* by the company's audit committee or [a comparable] *another independent body of the board of directors* [to review potential conflicts of interest situations where appropriate]. *For purposes of this rule, the term "related party transaction" shall refer to transactions required to be disclosed pursuant to SEC Regulation S-K, Item 404.*

\* \* \* \* \*

Rule 31.10 Corporate Governance [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.]

(a) *Composition of Board of Directors*  
 (1) A majority of the board of directors of an issuer must be comprised of independent directors. The company must disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board of directors has determined to be independent under Rule 31.10(h)(2). If an issuer fails to comply with this requirement due to one vacancy, or one director ceases to be independent due to circumstances beyond his or her reasonable control, the issuer shall regain compliance with the requirement by the earlier of its next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on this provision shall provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

(2) Independent directors must have regularly scheduled meetings at which only independent directors are present ("executive sessions").

(b) *Audit Committee*

[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"). In addition to the listing standards provided in Exchange Act Rule 10A-3 that relate to audit committee responsibilities, audit committees for investment companies must establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.]

(1) *Audit Committee Composition*

(A) Each issuer must have, and certify that it has and will continue to have, an audit committee of at least three members, each of whom must (i) be independent as defined in Rule 31.10(h)(2); (ii) meet the criteria for independence set forth in Exchange Act Rule 10A-3(b)(1) (subject to the exemptions provided in Rule 10A-3(c)); and (iii) be able to read and understand fundamental financial statements, including a company's balance sheet, income statement, and cash flow statement. Additionally, each issuer must certify that it has, and will continue to have, at least one member of the audit committee who is

financially sophisticated, in that he or she has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(B) Notwithstanding Rule 31.10(b)(1)(A)(i), one director who: (i) is not independent as defined in Rule 31.10(h)(2); (ii) meets the criteria set forth in Section 10A(m)(3) of the Exchange Act and the rules thereunder; and (iii) is not a current officer or employee or a family member of such officer or employee, may be appointed to the audit committee, if the board, under exceptional and limited circumstances, determines that membership on the committee by the individual is required by the best interests of the company and its shareholders, and the board discloses, in the next annual proxy statement subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for that determination. A member appointed under this exception may not serve longer than two years and may not chair the audit committee.

(2) *Audit Committee Responsibilities and Authority*

The audit committee must have the specific audit committee responsibilities and authority necessary to comply with Exchange Act Rules 10A-3(b)(2)-(5) (subject to the exemptions provided in Rule 10A-3(c)) concerning responsibilities relating to: (i) registered public accounting firms; (ii) complaints relating to accounting, internal accounting controls or auditing matters; (iii) authority to engage advisors; and (iv) funding as determined by the audit committee. Audit committees for investment companies must also establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.

(3) *Audit Committee Charter*

Each issuer must certify that it has adopted a formal written audit committee charter and that the audit committee has reviewed and reassessed the adequacy of the formal written

charter on an annual basis. The charter must specify:

(A) The scope of the audit committee's responsibilities, and how it carries out those responsibilities, including structure, processes, and membership requirements;

(B) The audit committee's responsibility for ensuring its receipt from the outside auditors of a formal written statement delineating all relationships between the auditor and the company, consistent with Independence Standards Board Standard 1, and the audit committee's responsibility for actively engaging in a dialogue with the auditor with respect to any disclosed relationships or services that may impact the objectivity and independence of the auditor and for taking, or recommending that the full board take, appropriate action to oversee the independence of the outside auditor;

(C) The committee's purpose of overseeing the accounting and financial reporting processes of the issuer and the audits of the financial statements of the issuer; and

(D) The specific audit committee responsibilities and authority set forth in Rule 31.10(b)(2).

(4) *Cure Periods*

(A) If a member of the audit committee ceases to be independent in accordance with the requirements of Exchange Act Rule 10A-3 and Rule 31.10(b)(1) 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. An issuer relying on this provision must provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

(B) If an issuer fails to comply with the audit committee composition requirement under Rule 31.10(b)(1)(A) due to one vacancy on the audit committee, and the cure period in Rule 31.10(b)(4)(A) is not otherwise being relied upon for another member, the issuer will have until the earlier of the next annual shareholders meeting or one year from the occurrence of the event that caused the failure to comply with this requirement. An issuer relying on the provision must provide notice to the Exchange immediately upon learning of the event or circumstance that caused the non-compliance.

(c) *Compensation of Officers*

(1) Compensation of the chief executive officer of the company must be determined, or recommended to the board for determination, either by:

(A) A majority of the independent directors; or

(B) A compensation committee comprised solely of independent directors.

The chief executive officer may not be present during voting or deliberations.

(2) Compensation of all other executive officers must be determined, or recommended to the board for determination, either by

(A) A majority of the independent directors; or

(B) A compensation committee comprised solely of independent directors.

(3) Notwithstanding paragraphs (c)(1)(B) and (c)(2)(B) above, if the compensation committee is comprised of at least three members, one director, who is not independent as defined in Rule 31.10(h)(2) and is not a current officer or employee or a family member of an officer or employee, may be appointed to the compensation committee if the board, under exceptional and limited circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for the next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.

(d) Nomination of Directors

(1) Director nominees must either be selected, or recommended for the Board's selection, either by:

(A) A majority of the independent directors; or

(B) A nominations committee comprised solely of independent directors.

(2) Each issuer must certify that it has adopted a formal written charter or board resolution, as applicable, addressing the nominations process and such related matters as may be required under the federal securities laws.

(3) Notwithstanding subparagraph (d)(1)(B) above, if the nominations committee is comprised of at least three members, one director, who is not independent as defined in Rule 31.10(h)(2) and is not a current officer or employee or a family member of an officer or employee, may be appointed to the nominations committee if the board, under exceptional and limited

circumstances, determines that such individual's membership on the committee is required by the best interests of the company and its shareholders, and the board discloses, in the proxy statement for the next annual meeting subsequent to such determination (or, if the issuer does not file a proxy, in its Form 10-K or 20-F), the nature of the relationship and the reasons for the determination. A member appointed under this exception may not serve longer than two years.

(4) Independent director oversight of director nominations shall not apply in cases where the right to nominate a director legally belongs to a third party. However, this does not relieve a company's obligation to comply with the committee composition requirements set forth in Rules 31.10(a)-(d).

(5) This Rule 31.10(d) is not applicable to a company if the company is subject to a binding obligation that requires a director nomination structure inconsistent with this rule and such obligation pre-dates the approval date of this rule.

(e) Each issuer shall adopt a code of conduct applicable to all directors, officers and employees, which shall be publicly available. A code of conduct satisfying this rule must comply with the definition of a "code of ethics" set out in Section 406(c) of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and any regulations promulgated thereunder by the Securities and Exchange Commission. See 17 CFR 228.406 and 17 CFR 229.406. In addition, the code must provide for an enforcement mechanism. Domestic issuers shall disclose code of conduct waivers in a Form 8-K within five business days. Foreign private issuers shall disclose such waivers either in a Form 6-K or in the next Form 20-F.

(f) Exemptions

(1) Controlled Companies. A controlled company is exempt from the requirements of Rules 31.10(a), (c) and (d), except that a controlled company must comply with (i) the provision in subsection (a)(1) that requires a company to disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board of directors has determined to be independent under Rule 31.10(h)(2) and (ii) the requirements of subsection (a)(2), which pertains to executive sessions of independent directors. For purposes of this Rule 31.10, a controlled company is a company of which more than 50% of the voting power is held by an individual, a group or another company. A controlled company relying upon this

exemption must disclose in its annual meeting proxy statement (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) that it is a controlled company and the basis for that determination.

(2) Registered Management Investment Companies. Management investment companies registered under the Investment Company Act of 1940 are exempt from the requirements of Rules 31.10(a), (c), (d) and (e). Such companies are otherwise required to comply with the remainder of Rule 31.10, except that open-end management investment companies are required to comply with Rule 31.10(b) only to the extent required by Exchange Act Rule 10A-3. In addition, open-end management investment companies must comply with the provision of Rule 31.10(b)(2) requiring audit committees of investment companies to establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company. This responsibility must be addressed in the audit committee charter.

(3) Asset-backed Issuers and Other Passive Issuers. The following are exempt from the requirements of Rules 31.10(a)-(e): (i) asset-backed issuers and (ii) issuers that are organized as trusts or other unincorporated associations that do not have a board of directors or persons acting in a similar capacity and whose activities are limited to passively owning or holding (as well as administering and distributing amounts in respect of) securities, rights, collateral or other assets on behalf of or for the benefit of the holders of the listed securities.

(4) Cooperatives. Cooperative entities, such as agricultural cooperatives, that are structured to comply with relevant state law and federal tax law and that do not have a publicly traded class of common stock are exempt from Rules 31.10(a), (c), (d) and (e). However, such entities must comply with all federal securities laws, including without limitation Exchange Act Section 10A(m) and Rule 10A-3 thereunder.

(5) Business Development Companies. Business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act of 1940 that are not registered under that Act, are subject to all corporate governance requirements.

(g) *Notifications.* An issuer must provide the Exchange with prompt notification after an executive officer of the issuer becomes aware of any material noncompliance by the issuer with the requirements of Rule 31.10.

(h) *Definitions*

For purposes of Chapter XXXI, the following terms shall have the respective meanings:

(1) "Family member" means a person's spouse, parents, children and siblings, whether by blood, marriage or adoption, or anyone residing in such person's home.

(2) "Independent director" means 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 company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The following persons shall not be considered independent:

(A) A director who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company;

(B) A director who accepted or who has a family member who accepted any payments from the company or any parent or subsidiary of the company in excess of \$60,000 during the current or any of the past three fiscal years, other than the following:

(i) Compensation for board or board committee service;

(ii) Payments arising solely from investments in the company's securities;

(iii) Compensation paid to a family member who is a non-executive employee of the company or a parent or subsidiary of the company;

(iv) Benefits under a tax-qualified retirement plan, or non-discretionary compensation; or

(v) Loans permitted under Exchange Act Section 13(k).

Provided, however, that audit committee members are subject to additional, more stringent requirements under Exchange Act Rule 10A-3, which requirements are incorporated by reference in the Exchange rules pursuant to Rule 31.10(b).

(C) A director who is a family member of an individual who is, or at any time during the past three years was, employed by the company or by any parent or subsidiary of the company as an executive officer;

(D) A director who is, or has a family member who is, a partner in, or a controlling shareholder or an executive officer of, any organization to which the company made, or from which the company received, payments for

property or services in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenues for that year, or \$200,000, whichever is more, other than the following:

(i) Payments arising solely from investments in the company's securities; or

(ii) Payments under non-discretionary charitable contribution matching programs;

(E) A director of the listed company who is, or has a family member who is, employed as an executive officer of another entity where at any time during the past three years any of the executive officers of the listed company serve on the compensation committee of such other entity;

(F) A director who is, or has a family member who is, a current partner of the company's outside auditor, or was a partner or employee of the company's outside auditor who worked on the company's audit at any time during any of the past three years; or

(G) In the case of an investment company, in lieu of Rules 31.10(h)(2)(A)-(F), a director who is an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee.

(i) *Effective Dates/Transition*

(1) In order to allow companies to make necessary adjustments in the course of their regular annual meeting schedule, and consistent with Exchange Act Rule 10A-3, Rules 31.10(a)-(d), (f) and (h) are effective as set forth below. During the transition period between July 9, 2004 and the applicable effective date, listed companies must comply with Rule 31.10 as in effect immediately prior to July 9, 2004 (see Rule 31.10.10).

- July 31, 2005 for foreign private issuers and small business issuers (as defined in Exchange Act Rule 12b-2); and

- For all other listed issuers, by the earlier of (1) the listed issuer's first annual shareholders meeting after July 31, 2004; or (2) October 31, 2004.

(2) In the case of an issuer with a staggered board, with the exception of the audit committee requirements, the issuer will have until its second annual meeting after January 15, 2004, but not later than December 31, 2005, to implement all of the new requirements, if the issuer would be required to change a director who would not normally stand for election at an earlier annual meeting. Such issuers must comply with the audit committee requirements

pursuant to the implementation schedule bulleted above.

(3) Issuers that will be listed in conjunction with their initial public offering will be afforded exemptions from all board composition requirements set forth in Rule 31.10 consistent with the exemptions afforded in Exchange Act Rule 10A-3(b)(1)(iv)(A). That is, for each committee that the company adopts, the company will be required to have one independent member at the time of listing, a majority of independent members within 90 days of listing, and all independent members within one year. It should be noted, however, that investment companies are not afforded these exemptions in Exchange Rule 10A-3(b)(1)(iv)(A). Companies emerging from bankruptcy or which have ceased to be controlled companies will be required to meet the majority independent board requirement within one year. As provided under the proposal, issuers may choose not to adopt a compensation or nomination committee and could instead rely upon a majority of the independent directors to discharge responsibilities under Exchange rules. These issuers will be required to meet the majority independent board requirement within one year of listing.

(4) Companies transferring from other markets with substantially similar board composition requirements will be afforded the balance of any grace period afforded by the other market. Companies transferring from other listed markets that do not have a substantially similar board composition requirements will be afforded one year from the date of listing on the Exchange to comply with the Exchange's board composition requirements. This transition period is not intended to supplant any applicable requirements of Exchange Act Rule 10A-3.

(5) Proposed Rule 31.10(d), which pertains to nominating committees, will not apply if the company is subject to a binding obligation that requires a director nomination structure inconsistent with Rule 31.10(d) and such obligation pre-dates the approval date of Rule 31.10(d).

(6) Compliance with proposed Rule 31.10(e), which requires issuers to adopt a code of conduct, will be required on July 31, 2004.

\* \* \* *Interpretations and Policies*

.01 *Definition of Independence.* It is important for investors to have confidence that individuals serving as independent directors do not have a relationship with the listed company that would impair their independence.

The board has a responsibility to make an affirmative determination that no such relationships exist through the application of Rule 31.10(h)(2). Rule 31.10(h)(2) also sets forth certain relationships that preclude a board finding of independence. These objective measures provide transparency to investors and companies, facilitate uniform application of the rules, and ease administration. Because the Exchange does not believe that ownership of company stock by itself would preclude a board finding of independence, it is not included in the aforementioned objective factors. It should be noted that there are additional, more stringent requirements that apply to directors serving on audit committees pursuant to Rule 31.10(b).

The rule's reference to a "parent or subsidiary" is intended to cover entities the issuer controls and consolidates with the issuer's financial statements as filed with the Securities and Exchange Commission (but not if the issuer reflects such entity solely as an investment in its financial statements). The reference to executive officer means those officers covered in Exchange Act Rule 16a-1(f). In the context of the definition of family member under Rule 31.10(h)(1), the reference to marriage is intended to capture relationships specified in the rule (parents, children and siblings) that arise as a result of marriage, such as "in-law" relationships.

The three year look-back periods referenced in Rules 31.10(h)(2)(A), (C), (E) and (F) commence on the date the relationship ceases. For example, a director employed by the company is not independent until three years after such employment terminates.

Rule 31.10(h)(2)(B) is generally intended to capture situations where a payment is made directly to (or for the benefit of) the director or a family member of the director. For example, consulting or personal service contracts with a director or family member of the director or political contributions to the campaign of a director or a family member of the director would be captured under Rule 31.10(h)(2)(B).

Rule 31.10(h)(2)(D) is generally intended to capture payments to an entity with which the director or family member of the director is affiliated by serving as a partner, controlling shareholder or executive officer of such entity. Under exceptional circumstances, such as where a director has direct, significant business holdings, it may be appropriate to apply the corporate measurements in Rule 31.10(h)(2)(D), rather than the

individual measurements in Rule 31.10(h)(2)(B). Issuers should contact the Exchange if they wish to apply the rule in this manner. The reference to a partner in Rule 31.10(h)(2)(D) is not intended to include limited partners. It should be noted that the independence requirements of Rule 31.10(h)(2)(D) are broader than Exchange Act Rule 10A-3(e)(8). Under Rule 31.10(h)(2)(D), a director who is, or who has a family member who is, an executive officer of a charitable organization may not be considered independent if the company makes payments to the charity in excess of the greater of 5% of the charity's revenues or \$200,000. However, the Exchange encourages companies to consider other situations where a director or his or her family member and the company each have a relationship with the same charity when assessing director independence.

For purposes of determining whether a lawyer is eligible to serve on an audit committee, Exchange Act Rule 10A-3 generally provides that any partner in a law firm that receives payments from the issuer is ineligible to serve on that issuer's audit committee. In determining whether a director may be considered independent for purposes other than the audit committee, payments to a law firm would generally be considered under Rule 31.10(h)(2)(D), which looks to whether the payment exceeds the greater of 5% of the recipients gross revenues or \$200,000; however, if the firm is a sole proprietorship, Rule 31.10(h)(2)(B), which looks to whether the payment exceeds \$60,000, applies.

Rule 31.10(h)(2)(G) provides a different measure for independence for investment companies in order to harmonize with the Investment Company Act of 1940. In particular, in lieu of Rules 31.10(h)(2)(A)-(F), a director who is an "interested person" of the company as defined in Section 2(a)(19) of the Investment Company Act of 1940, other than in his or her capacity as a member of the board of directors or any board committee, would not be considered independent.

.02 **Majority Independent Board.** Independent directors play an important role in assuring investor confidence. Through the exercise of independent judgment, they act on behalf of investors to maximize shareholder value in the companies they oversee and guard against conflicts of interest. Requiring that the board be comprised of a majority of independent directors empowers such directors to carry out more effectively these responsibilities.

.03 **Audit Committees.**

**Audit Committee Composition.** Audit committees are required to have a minimum of three members and be comprised only of independent directors. In addition to satisfying the independent director requirements under Rule 31.10(h)(2), audit committee members must meet the criteria for independence set forth in Exchange Act Rule 10A-3(b)(1) (subject to the exemptions provided in Exchange Act Rule 10A-3(c)): They must not accept any consulting, advisory, or other compensatory fee from the company other than for board service, and they must not be an affiliated person of the company. It is recommended that an issuer disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) if any director is deemed independent but falls outside the safe harbor provisions of Exchange Act Rule 10A-3(e)(1)(ii). A director who qualifies as an audit committee financial expert under Item 401(h) of Registration S-K, Item 401(e) of Regulation S-B, or Item 3 of Form N-CSR (in the case of a registered management investment company) is presumed to qualify as a financially sophisticated audit committee member under Rule 31.10(b)(1)(A).

**Audit Committee Responsibilities and Authority.** Audit committees must have the specific audit committee responsibilities and authority necessary to comply with Exchange Act Rules 10A-3(b)(2)-(5) (subject to the exemptions provided in Exchange Act Rule 10A-3(c)), concerning responsibilities relating to registered public accounting firms; complaints relating to accounting; internal accounting controls or auditing matters; authority to engage advisors; and funding. Audit committees for investment companies must also establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.

**Audit Committee Charter.** Each issuer is required to adopt a formal written charter that specifies the scope of its responsibilities and the means by which it carries out those responsibilities; the outside auditor's accountability to the audit committee; and the audit committee's responsibility to ensure the independence of the outside auditor. Consistent with this, the charter must specify all audit committee responsibilities set forth in Exchange

Act Rules 10A-3(b)(2)-(5). Exchange Act Rule 10A-3(b)(3)(ii) requires that each audit committee must establish procedures for the confidential, anonymous submission by employees of the listed issuer of concerns regarding questionable accounting or auditing matters. The rights and responsibilities as articulated in the audit committee charter empower the audit committee and enhance its effectiveness in carrying out its responsibilities. Rule 31.10(b)(2) imposes additional requirements for investment company audit committees that must also be set forth in audit committee charters for these issuers.

.04 *Executive Sessions of Independent Directors.* Regularly scheduled executive sessions encourage and enhance communication among independent directors. It is contemplated that executive sessions will occur at least twice a year, and perhaps more frequently, in conjunction with regularly scheduled board meetings.

.05 *Independent Director Oversight of Executive Compensation.* Independent director oversight of executive officer compensation helps assure that appropriate incentives are in place, consistent with the board's responsibility to maximize shareholder value. The rule is intended to provide flexibility for an issuer to choose an appropriate board structure and to reduce resource burdens, while ensuring independent director control of compensation decisions.

.06 *Independent Director Oversight of Director Nominations.* Independent director oversight of nominations enhances investor confidence in the selection of well-qualified director nominees, as well as independent nominees as required by the rules. Rule 31.10(d) is also intended to provide flexibility for a company to choose an appropriate board structure to reduce resource burdens, while ensuring that independent directors approve all nominations.

Rule 31.10(d) does not apply in cases where the right to nominate a director legally belongs to a third party. For example, investors may negotiate the right to nominate directors in connection with an investment in the company, holders of preferred stock may be permitted to nominate or appoint directors upon certain defaults, or the company may be a party to a shareholders' agreement that allocates the right to nominate some directors. Because the right to nominate directors in these cases does not reside with the company, independent director approval would not be required. This rule is not applicable if the company is

subject to a binding obligation that requires a director nomination structure inconsistent with Rule 31.10(d) and such obligation pre-dates the approval date of Rule 31.10(d).

.07 *Code of Conduct Ethical behavior is required and expected of every corporate director, officer and employee whether or not a formal code of conduct exists. The requirement of a publicly available code of conduct applicable to all directors, officers and employees of an issuer is intended to demonstrate to investors that the board and management of Exchange issuers have carefully considered the requirement of ethical dealing and have put in place a system to ensure that they become aware of and take prompt action against any questionable behavior. For company personnel, a code of conduct with enforcement provisions provides assurance that reporting of questionable behavior is protected and encouraged, and fosters an atmosphere of self-awareness and prudent conduct.*

Rule 31.10(e) requires issuers to adopt a code of conduct complying with the definition of a "code of ethics" under Section 406(c) of the Sarbanes-Oxley Act and any regulations promulgated thereunder by the Securities and Exchange Commission. Thus, the code must include such standards as are reasonably necessary to promote the ethical handling of conflicts of interest, full and fair disclosure, and compliance with laws, rules and regulations, as specified by the Sarbanes-Oxley Act. However, the code of conduct required by Rule 31.10(e) must apply to all directors, officers and employees. Issuers can satisfy this obligation by adopting one or more codes of conduct, such that all directors, officers and employees are subject to a code that satisfies the definition of a "code of ethics."

As the Sarbanes-Oxley Act recognizes, investors are harmed when the real or perceived private interests of a director, officer or employee is in conflict with the interests of the company, as when the individual receives improper personal benefits as a result of his or her position with the company, or when the individual has other duties, responsibilities or obligations that run counter to his or her duty to the company. Also, the disclosures an issuer makes to the Securities and Exchange Commission are the essential source of information about the company for regulators and investors—there can be no question about the duty to make them fairly, accurately and timely. Finally, illegal action must be dealt with swiftly and the violators

reported to the appropriate authorities. Each code of conduct must require that any waiver of the code for executive officers or directors may be made only by the board and must be promptly disclosed to shareholders, along with the reasons for the waiver. This disclosure requirement provides investors the comfort that waivers are not granted except where they are truly necessary and warranted, and that they are limited and qualified so as to protect the company to the greatest extent possible. Consistent with applicable law, domestic issuers shall disclose such waivers in a Form 8-K within five business days. Foreign private issuers shall disclose such waivers either in a Form 6-K or in the next Form 20-F.

Each code of conduct must also contain an enforcement mechanism that ensures prompt and consistent enforcement of the code, protection for persons reporting questionable behavior, clear and objective standards for compliance, and a fair process by which to determine violations.

.08 *Exemptions. (a) Controlled Companies.* This exemption recognizes that majority shareholders, including parent companies, have the right to select directors and control certain key decisions, such as executive officer compensation, by virtue of their ownership rights. In order for a group to exist for purposes of this rule, the shareholders must have publicly filed a notice that they are acting as a group (e.g., a Schedule 13D). A controlled company not relying upon this exemption need not provide any special disclosures about its controlled status. It should be emphasized that this controlled company exemption does not extend to the audit committee requirements under Rule 31.10(b) or the requirement for executive sessions of independent directors under Rule 31.10(a)(2).

(b) *Registered Management Investment Companies.* Management investment companies registered under the Investment Company Act of 1940 are already subject to a pervasive system of federal regulation in certain areas of corporate governance covered by Rule 31.10. In light of this, the Exchange exempts from Rules 31.10(a), (c), (d) and (e) management investment companies registered under the Investment Company Act of 1940.

(c) *Asset-backed Issuers and Other Passive Issuers.* Because of their unique attributes, Rules 31.10(a)-(e) do not apply to asset-backed issuers and issuers that are organized as trusts (including trusts issuing UIT interests (including IPRs) and Trust Issued Receipts, as those terms are defined in

Rule 1.1 and the Interpretations and Policies thereunder, provided that such trusts meet the requirements of this Rule 31.10 or other unincorporated associations that do not have a board of directors or persons acting in a similar capacity and whose activities are limited to passively owning or holding (as well as administering and distributing amounts in respect of) securities, rights, collateral or other assets on behalf of or for the benefit of the holders of the listed securities.

(d) Cooperatives. Certain member-owned cooperatives that list their preferred stock are required to have their common stock owned by their members. Because of their unique structure and the fact that they do not have a publicly traded class of common stock, such entities are exempt from Rules 31.10(a), (c), (d) and (e).

.09 References to executive officers in Rule 31.10 mean those officers covered in Exchange Act Rule 16a-1(f).

.10 The following is the text of Rule 31.10 as in effect immediately prior to July 9, 2004.

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 31.60 Publication of Annual Report

(a) A listed company is required to publish and furnish to its shareholders (or to holders of any other listed security when its common stock is not

listed on a national securities exchange) an annual report containing audited financial statements of the company and its subsidiaries. Six copies of the report must be filed with the Exchange.

(b) An issuer that receives an audit opinion that contains a going concern qualification must make a public announcement through the news media disclosing the receipt of such qualification. Prior to the release of the public announcement, the issuer must provide the text of the public announcement to the Regulatory Services Division of the Exchange. The public announcement shall be provided to the Regulatory Service Division and released to the media not later than seven calendar days following the filing of such audit opinion in a public filing with the Securities and Exchange Commission.

\* \* \* \* \*

Rule 31.94 Suspension and Delisting Policies

A.-B. No change.
C. Application of Policies
(a)-(c) No change.
(d) Failure to comply with Listing Agreements—The securities of a company failing (or for the transfer agent or registrar of which fails) to comply with the Exchange rules in any material respect (e.g., failure to distribute annual reports when due, failure to report interim earnings, failure to observe Exchange policies regarding timely disclosure of important corporate developments, failure to solicit proxies, issuance of additional shares of a listed class without prior listing thereof, failure to obtain shareholder approval of corporate action without prior listing thereof, failure to obtain shareholder approval of corporate action where required by Exchange policies, failure to comply with Exchange corporate governance listing requirements, etc.) are subject to suspension from dealings and, unless prompt corrective action is taken, removal from listing.

(e) Convertible Bonds—A debt security convertible into a listed equity security will be reviewed when the underlying equity security is delisted and will be delisted when the underlying equity security is no longer subject to real-time trade reporting. In addition, if the common stock is delisted for violation of any of the following Exchange rules relating to corporate governance, the Exchange will also delist any listed debt securities convertible into that common stock:

- Rule 31.9—Conflicts of Interest
Rule 31.10—[Independent Directors] Corporate Governance

- Rule 31.11—Common Voting Rights
Rule 31.12—Quorum
Rule 31.13—Preferred Voting Rights
Rule 31.14—Bondholders Remedies Upon Default

(f) No change.
D.-I. No change.
\* \* \* \* \*

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 Rules 31.7(2), 31.9, 31.10 and 31.60(b) and Exchange Act Rule 10A-3 [of the Securities Exchange Act of 1934, as amended], (iii) upon learning of the event or circumstance that causes the listed company to no longer comply with the board composition requirements set forth in Rule 31.10(a)(1), and (iv) upon learning of the event or circumstance that causes the listed company to rely on Rules 31.10(b)(4)(A) or (B).

C.-H. 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 (including any time a majority of the Company's Board of Directors fails to be comprised of independent directors), its independent public accountants, its transfer agent or registrar and material noncompliance by the listed company with the requirements of Rules 31.7(2), 31.9, 31.10 and 31.60(b) and Exchange Act 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.-13. No change.

14. *Comply with the corporate governance listing requirements set forth in Rules 31.7(2), 31.9, 31.10 and 31.60(b), including the maintenance [Maintain] of at least a majority of [two] independent directors [(defined as directors who are not officers or beneficial holders of 10% or more of the securities of the Company or affiliates of such persons and who, in the view of the Company's Board of Directors, are free of any relationship that would interfere with the exercise of independent judgment)] on the Company's Board of Directors and compliance with Exchange Act Rule 10A-3. No director shall be qualified as independent unless the Company's Board of Directors affirmatively determines that the director qualifies as an "independent director" pursuant to Rule 31.10(h)(2).*

15.-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 Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange 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 III below. The Exchange 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 Exchange is proposing a comprehensive package of corporate governance reforms with respect to its non-option listing standards in order to promote accountability, transparency, and integrity of companies listing their non-option securities on the Exchange.<sup>5</sup> The proposal encompasses significant changes in the following areas based on

<sup>5</sup> In File No. SR-CBOE-2003-31, the Exchange represented that it would adopt additional listing policies and requirements pertaining to issuer corporate governance. See Securities Exchange Act Release No. 48838 (November 25, 2003), 68 FR 67708 (December 3, 2003). The Exchange states that this current proposed rule change would serve to satisfy that representation.

the corporate governance reforms of the National Association of Securities Dealers, Inc. ("NASD") through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq");<sup>6</sup> board of directors composition and independence standards; compensation of executive officers; nominations; audit committees; and ethics and disclosure obligations. The Commission has already approved the Exchange's proposed rule change relating to shareholder approval requirements for equity compensation plans.<sup>7</sup>

*Independent Directors.* Current CBOE Rule 31.10 requires an issuer to have at least two independent directors and defines "independent director" as "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." Other than these standards, the Exchange rules contain no other criteria with respect to the definition of "independent director" and to board composition requirements. The Exchange proposes to replace current CBOE Rule 31.10 with new rules because the Exchange believes that it is important for investors to have confidence that individuals serving as independent directors do not have a relationship with the listed company that would impair their independence. In this regard, proposed CBOE Rule 31.10(h)(2) would provide new standards with respect to the definition of "independent director," and proposed CBOE Rule 31.10(a) would set forth new requirements for the composition of the board of directors.<sup>8</sup> In addition, through the application of CBOE Rule 31.10(h)(2), the proposed rules would require the board to make an affirmative determination that no such relationships exist. Proposed CBOE Rule 31.10(h)(2) also would preclude a board finding of independence with respect to relationships between directors and certain individuals. The Exchange believes that these objective measures would provide transparency to investors and companies, facilitate uniform

<sup>6</sup> See Securities Exchange Act Release No. 48745 (November 4, 2003), 68 FR 64154 (November 12, 2003) (approving changes to the corporate governance listing standards of Nasdaq and the New York Stock Exchange, Inc. ("NYSE")).

<sup>7</sup> See Securities Exchange Act Release No. 48737 (October 31, 2003), 68 FR 63150 (November 7, 2003) (SR-CBOE-2003-45).

<sup>8</sup> See CBOE Rule 31.10(f), discussed below, regarding entities exempted from these requirements.

application of the rules, and ease administration.

The reference to a "parent or subsidiary" in proposed CBOE Rule 31.10(h)(2) would cover entities that the issuer controls and consolidates with the issuer's financial statements as filed with the Commission, but not if the issuer reflects such an entity solely as an investment in its financial statements. In the context of the definition of "family member" under proposed CBOE Rule 31.10(h)(1), the reference to marriage would capture relationships specified in the rule (parents, children, and siblings) that would arise as a result of marriage, such as "in-law" relationships.

The three-year look-back periods referenced in proposed CBOE Rules 31.10(h)(2)(A), (C), (E) and (F) would commence on the date the relationship ceases. Proposed CBOE Rule 31.10(h)(2)(B) would generally capture situations where a payment is made directly to (or for the benefit of) the director or a family member of the director. Proposed CBOE Rule 31.10(h)(2)(D) would generally capture payments to an entity which the director or family member of the director is affiliated by serving as a partner, controlling shareholder or executive officer of such entity. Under proposed CBOE Rule 31.10(h)(2)(D), a director who is, or who has a family member who is, an executive officer of a charitable organization would not be considered independent if the company makes payments to the charity in excess of the greater of 5% of the charity's revenues or \$200,000. Proposed CBOE Rule 31.10(h)(2)(G) would provide a different measure of independence for investment companies, consistent with the Investment Company Act of 1940.

*Independent Board and Board Committees.* Proposed CBOE Rule 31.10(a) would require independent directors to comprise a majority of a listed issuer's board of directors,<sup>9</sup> and thus play an important role in assuring investor confidence. The Exchange believes that, through the exercise of independent judgment, they would act on behalf of investors to maximize shareholder value in the companies they oversee, and guard against conflicts of interest. The Exchange believes that requiring that the board be comprised of a majority of independent directors would empower such directors to more effectively carry out these responsibilities. The proposed rule change also would require regularly

<sup>9</sup> Id.



convened executive sessions of independent directors.

Furthermore, proposed CBOE Rule 31.10(c) would require independent director approval of executive officer compensation. The Exchange believes that this oversight would help assure that appropriate incentives are in place, consistent with the board's responsibility to maximize shareholder value and comply with applicable law. Proposed CBOE Rule 31.10(d) also would require independent director approval for director nominations. The Exchange believes that independent director oversight of nominations would enhance investor confidence in the selection of well-qualified director nominees, as well as independent nominees as required by the rules. The Exchange represents that these proposed rules are intended to provide flexibility for a company to choose an appropriate board structure and reduce resource burdens.

Under proposed CBOE Rule 31.10(f)(1), a controlled company would be exempt from the requirements of proposed CBOE Rules 31.10(a), (c), and (d), with the exception of proposed CBOE Rule 31.10(a)(1), which requires a controlled company to disclose in its annual proxy (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) those directors that the board of directors has determined to be independent under Rule 31.10(h)(2), and proposed CBOE Rule 31.10(a)(2), which pertains to executive sessions of independent directors.<sup>10</sup> The rule proposal would define a controlled company as a company of which more than 50% of the voting power is held by an individual, a group or another company. A controlled company relying upon this exemption would be required to disclose in its annual meeting proxy statement (or, if the issuer does not file a proxy, in its Form 10-K or 20-F) that it is a controlled company and the basis for that determination.

**Audit Committee Requirements.** Proposed CBOE Rule 31.10(b) would restate the Exchange's current audit committee requirements, including the requirement to comply with the listing standards set forth in Rule 10A-3 under the Act, as well as proposed terms that expand the current requirements.<sup>11</sup> Under the proposed rules, audit committees would be required to have a minimum of three members, all of whom would be required to satisfy the independence standards set forth in

Rule 10A-3(b)(1) under the Act (subject to applicable exemptions), and proposed CBOE Rule 31.10(h)(2). The proposal also would specify that audit committees must have the specific audit committee responsibilities and authority necessary to comply with Rule 10A-3(b)(2)-(5) under the Act (subject to applicable exemptions). Furthermore, the proposal would require audit committee members to be able to read and understand fundamental financial statements at the time they join the board.

The proposed rule change also would require audit committees to adopt a charter that specifies all audit committee responsibilities required by Rule 10A-3 under the Act. The proposal would require investment company audit committees to establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters by employees of the investment adviser, administrator, principal underwriter, or any other provider of accounting related services for the investment company, as well as employees of the investment company.

**Going Concern Qualification.** Proposed CBOE Rule 31.60(b) would require issuers to disclose in a press release the receipt of an audit opinion with a going concern qualification. The Exchange states that, ordinarily, the continuation of an entity as a going concern is assumed in financial reporting in the absence of significant evidence to the contrary. If an auditor concludes that substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time, however, the auditor provides this conclusion through an explanatory paragraph in the auditor's report. While the audit opinion is available in the Form 10-K, the Exchange believes that receipt of a going concern qualification is so material that it should be brought to the attention of investors and potential investors through a press release issued promptly after the filing of the Form 10-K.

**Review of Related Party Transactions.** The Exchange proposes to expand its current conflict of interest rule set forth in CBOE Rule 31.9 by requiring the audit committee or another independent body of the board of directors to approve, rather than merely review, related party transactions. All directors that review and approve a related party transaction must be independent as specified under Exchange rules.

**Code of Conduct.** Proposed CBOE Rule 31.10(e) would require listed companies to adopt and make publicly available a code of conduct applicable

to directors, officers, and employees that complies with the definition of a "code of ethics" set forth in Section 406(c) of the Sarbanes-Oxley Act of 2002 and any regulations promulgated by the Commission thereunder, and to provide for an enforcement mechanism.<sup>12</sup> Any waivers of the code for directors or executive officers would be required to be approved by the board and be disclosed in a Form 8-K, Form 6-K or Form 20-F. Domestic issuers would be required to disclose such waivers in a Form 8-K within five business days. Foreign private issuers would be required to disclose such waivers either in a Form 6-K or in the next Form 20-F.

**Exemptions.** Current CBOE Rule 31.7(2) permits non-U.S. issuers listed on the Exchange to obtain exemptions from the Exchange's corporate governance standards if such rules would require the issuer to do anything contrary to the laws and generally accepted commercial and business practice of the issuer's domicile, to the extent such law and generally accepted commercial and business practice is consistent with federal securities laws. To make the current exemption process more transparent, proposed CBOE Rule 31.7(2) would require a foreign issuer to disclose the receipt of a corporate governance exemption from the Exchange in its annual report for the year the exemption is granted and on annual basis thereafter. Such disclosure would be required to be made in the issuer's annual filing of its financial statements with the Commission and the Exchange on Form 20-F, Form 40-F, or in certain cases, Form 10-K.

Since management investment companies registered under the Investment Company Act of 1940 are already subject to a pervasive system of federal regulation, proposed CBOE Rule 31.10(f)(2) would exempt management investment companies registered under the Investment Company Act of 1940 from proposed CBOE Rules 31.10(a), (c), (d) and (e). However, registered management investment companies would be subject to all of the audit committee requirements set forth in CBOE Rule 31.10(b), and open-end management investment companies would be subject to certain provisions of CBOE Rule 31.10(b) audit committee requirements.

In its audit committee rules under the Sarbanes-Oxley Act of 2002, the Commission excluded asset-backed issuers from the new requirements, and allowed markets to exclude from the requirements of Section 10A(m) of the

<sup>10</sup> See Amendment No. 1, *supra* note 3.

<sup>11</sup> See CBOE Rule 31.10(f), discussed below, regarding entities excepted from these requirements.

<sup>12</sup> See *id.*

Act and Rule 10A-3 thereunder certain "issuers" that are organized as trusts or other unincorporated associations having certain characteristics.

Accordingly, proposed CBOE Rule 31.10(f)(3) would exempt these entities from proposed CBOE Rules 31.10(a)-(e).

In light of their unique attributes, proposed CBOE Rule 31.10(f)(4) would exempt from proposed CBOE Rules 31.10(a), (c), (d) and (e) certain cooperative entities, such as agricultural cooperatives, that are structured to comply with, among other things, relevant state law and federal tax law and that do not have a publicly traded class of common stock. However, these entities must comply with Section 10A(m) of the Act and Rule 10A-3 thereunder.

Furthermore, CBOE proposes to clarify in proposed CBOE Rule 31.10(f)(5) that business development companies, which are a type of closed-end management investment company defined in Section 2(a)(48) of the Investment Company Act of 1940 that are not registered under that Act, would be subject to all of the Exchange's corporate governance requirements.<sup>13</sup>

**Implementation Periods.** Consistent with Rule 10A-3 of the Act, CBOE Rules 31.10(a)-(d), (f) and (h) would be effective as set forth below. During the transition period between the date of approval of this proposed rule change and the applicable effective date, listed companies would be required to comply with CBOE Rule 31.10 as in effect immediately prior to the date of approval of this rule filing.<sup>14</sup>

- July 31, 2005 for foreign private issuers and small business issuers (as defined in Rule 12b-2 under the Act); and

- For all other listed issuers, by the earlier of (1) the listed issuer's first annual shareholders meeting after July 31, 2004; or (2) October 31, 2004.

In the case of an issuer with a staggered board, with the exception of the audit committee requirements, the issuer would have until its second annual meeting after January 15, 2004, but not later than December 31, 2005, to implement all of the new requirements, if the issuer would be required to change a director who would not normally stand for election at an earlier annual meeting. Such issuers would be required to comply with the audit committee requirements pursuant to the implementation schedule set forth above.

Issuers that will be listed in conjunction with their initial public

offering would be afforded exemptions from all board composition requirements consistent with the exemptions afforded in Rule 10A-3(b)(1)(iv)(A) under the Act. That is, for each committee that the company adopts, the company would be required to have one independent member at the time of listing, a majority of independent members within 90 days of listing, and all independent members within one year. It should be noted, however, that investment companies would not be afforded these exemptions in Rule 10A-3(b)(1)(iv)(A) under the Act. Companies emerging from bankruptcy or which have ceased to be controlled companies would be required to meet the majority independent board requirement within one year. As provided under the proposal, issuers could choose not to adopt a compensation or nomination committee and could instead rely upon a majority of the independent directors to discharge responsibilities under Exchange rules. These issuers would be required to meet the majority independent board requirement within one year of listing.

Companies transferring from other markets with substantially similar board composition requirements would be afforded the balance of any grace period afforded by the other market.

Companies transferring from other listed markets that do not have a substantially similar board composition requirements would be afforded one year from the date of listing on the Exchange to comply with the Exchange's board composition requirements. This transition period is not intended to supplant any applicable requirements of Rule 10A-3 under the Act.

Proposed CBOE Rule 31.10(d), which pertains to nominating committees, would not apply if the company is subject to a binding obligation that requires a director nomination structure inconsistent with CBOE Rule 31.10(d) and such obligation pre-dates the approval date of CBOE Rule 31.10(d).

Compliance with proposed CBOE Rule 31.10(e), which requires issuers to adopt a code of conduct, would be required on July 31, 2004.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>15</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>16</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and

equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, protect investors and the public interest and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. Specifically, the proposed rule change is designed to increase investor protection by promoting accountability, transparency, and integrity by listed companies.

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

The proposed rule change will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the 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. 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. Comments may be submitted by any of the following methods:

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-28 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-28. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule

<sup>13</sup> See Amendment No. 1, *supra* note 3.

<sup>14</sup> See proposed CBOE Rule 31.10.10.

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

<sup>16</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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2004-28 and should be submitted on or before August 5, 2004.

#### IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission 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>17</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>18</sup> in that it is designed, among other things, to facilitate transactions in securities, to prevent fraudulent and manipulative acts and practices, 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, and does not permit unfair discrimination among issuers.

In the Commission's view, the proposed rule change will foster greater transparency, accountability, and objectivity in the oversight by, and decision-making processes of, the boards and key committees of CBOE listed issuers. The proposal also will promote compliance with high standards of conduct by the issuers' directors and management. The Commission notes that the CBOE's proposal is similar to proposals of other self-regulatory organizations ("SROs") recently approved by the Commission.

The CBOE has requested that the Commission grant accelerated approval

to the proposed rule change, as amended, so that the proposed corporate governance listing standards can be quickly implemented. The Commission believes that the revisions proposed by the Exchange significantly align the corporate governance standards proposed for companies listed on the CBOE with the standards approved by the Commission for companies listed on other SROs.<sup>19</sup> The Commission believes it is appropriate to accelerate approval of the proposed rule change so that the comprehensive set of strengthened corporate governance standards for companies listed on the CBOE may be implemented on generally the same timetable (with some modification of certain deadlines) as that for similar standards adopted for issuers listed on other SROs. The Commission therefore finds good cause, consistent with Section 19(b)(2) of the Act,<sup>20</sup> to approve the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**.

#### V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change, as amended (SR-CBOE-2004-28) be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

Dated:

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 04-16052 Filed 7-14-04; 8:45 am]

**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49994; File No. SR-CHX-2004-20]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by The Chicago Stock Exchange, Incorporated to Reinstate and Extend a Pilot Rule Interpretation Relating To Trading of Nasdaq/National Market Securities in Subpenny Increments

July 9, 2004.

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 July 6, 2004, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change, as described in Items I and II, below, which Items have been prepared by the Exchange. The Exchange has filed this proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comment 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 immediately reinstate and extend through June 30, 2005, the pilot rule interpretation relating to the trading of Nasdaq/National market securities in subpenny increments. The CHX represents that it does not propose to make any substantive or typographical changes to the pilot; the only change is to immediately reinstate the pilot and extend its expiration date through June 30, 2005. The text of the proposed rule change is available at the Commission and at the CHX.

#### 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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposal. The text of these statements

<sup>17</sup> 15 U.S.C. 78f(b). In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>18</sup> 15 U.S.C. 78f(b)(5).

<sup>19</sup> See *supra* note 6.

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</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> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).