



Information Circular IC03-121

Date: October 8, 2003

To: Membership

From: Board of Directors

Re: Membership Vote Regarding Proposed Governance Changes

At its July 30, 2003 meeting, the Exchange's Governance Committee¹ recommended and the Board approved a number of amendments to the CBOE Constitution and certain other rules and procedures pertaining to the governance of the Exchange. These governance recommendations were previously reviewed and endorsed by various Exchange constituencies, including the Lessors Advisory Committee. These proposed changes are intended to further enhance the fair and efficient governance of the Exchange and modernize various provisions of the Exchange's governance structure.

The recommendations to amend the Constitution require your approval through a membership vote. In addition to the constitutional changes, the Board is seeking your approval to amend Exchange Rule 8.82, governing the composition of the Modified Trading System Appointments Committee ("MTS Committee"). A booklet containing the Constitution and Rule 8.82 (both of which are marked to show all of the proposed amendments) is enclosed. This Information Circular explains those recommendations. The Board has called a special meeting of the membership to be held on Monday, October 27, 2003, for the purpose of holding a membership vote on the proposed amendments.²

The Board recommends that the membership vote **FOR** the proposed amendments, which the Board believes will further improve the Exchange's governance provisions and procedures, as well as update the CBOE Constitution to reflect current rules and practice.³

Summary of Proposed Amendments

The following summary organizes the recommendations to be voted upon based on the body, position, or function that is affected by the proposed amendments. Numbered paragraphs indicate the specific amendments that are being presented to the membership for approval. Non-numbered paragraphs are explanatory comments.

¹ The members of the Governance Committee are Robert J. Birnbaum, Chairman, William Power, Vice Chairman, Leon T. Kendall, Duane R. Kullberg, Richard F. Lynch, Scott Marks, R. Eden Martin, Thomas A. Petrone, John E. Smollen, Edward T. Tilly, and Alvin G. Wilkinson.

² The proposed Constitutional amendments and rule changes also require and are subject to the approval of the Securities and Exchange Commission.

³ The voting materials will be mailed to voting members on October 10, 2003 and will also include a copy of the booklet containing the Constitution and Rule 8.82, as proposed to be amended. Members may also view the highlighted Constitution and Rule 8.82 booklet on the Membership site at www.cboe.com.

Board of Directors and Vice Chairman

With respect to Constitution provisions relating to the Board of Directors and the Vice Chairman of the Board, the Board proposes to:

- (1) Amend Constitution Sections 6.1(b), 6.4, and 8.1 to specify that the directors and the Vice Chairman take office on January 1st.

Currently, the Constitution provides that the term of office of directors and the Vice Chairman start at the first regular meeting of the Board held after January 1 following the annual election, or until their successors are duly elected and qualified. The amendment moves the term start date up to January 1st.

- (2) Amend Constitution Section 6.3(b) to provide the later of 45 days or until the next regular Board meeting for a director who fails to maintain qualifications for a designated category to requalify.

This amendment addresses the situation in which a director fails to maintain all of the qualifications for his/her position. Adopting this amendment to Section 6.3(b) would allow a director the later of 45 days or until the next regular Board meeting to reestablish his/her qualifications, provided that the director may not act in the capacity of a director during the period in which s/he fails to qualify.⁴ This time period will start to run when the Board determines the director is unqualified, and the Board will be the sole judge of whether or not the director has requalified.

Nominating Committee

With respect to Constitutional provisions relating to the Nominating Committee, the Board proposes to:

- (3) Amend Section 4.1(b) to exempt members of the Nominating Committee who have not served a full 3-year term from the Constitutional provision that provides that "Elected members of the Nominating Committee shall be ineligible for reelection for a period of three years after their terms expire."

This amendment will allow a member of the Nominating Committee who was elected to a short term as a result of a vacancy to stand for reelection.

- (4) Amend Constitution Section 4.3 to delete the requirement that the Nominating Committee must hold three meetings in October, and also to require that the Nominating Committee announce its slate of candidates not later than October 10th or the first business day thereafter if the 10th is not a business day.

The Board believes there is no reason to restrict the Nominating Committee's ability to meet when it is most convenient to do so.

- (5) Adopt new Constitution Section 4.8 to require that members of the Nominating Committee shall meet the eligibility criteria for the category to which they were elected (floor, firm, lessor or public member) continuously and not only during the time periods in which the Nominating Committee is in session. The new section would also specify that the sole judge of whether a Nominating Committee member satisfies the qualification criteria for the category to which the

⁴ To ensure that the Board reviews situations in which a director may fail to maintain the qualifications for his/her position, the Board is also adopting the following policy. "Whenever the Secretary of the Exchange has reason to believe that a director may no longer qualify for the category to which s/he was elected or appointed, the Secretary will notify the Board of Directors of the director's possible disqualification no later than the next regular Board meeting."

committee member was elected is the Board of Directors. In addition, this new Section would also provide that a member of the Nominating Committee who fails to maintain the applicable qualifications has 45 days from the date the Board determines the member is not qualified to requalify.

- (6) Adopt new Constitution Section 4.9 to specify that the Board may remove Nominating Committee members for cause.

This proposed new section is consistent with Constitution Section 6.3(c) which allows the Board to remove a director for cause.

MTS Committee

With respect to the rules relating to the MTS Committee, the Board proposes to:

- (7) Amend Exchange Rule 8.82 to provide that the 9 elected MTS Committee members will include:

- 3 persons whose primary business is as a Market-Maker,
- 3 persons whose primary business is as a Market-Maker or as a DPM Designee, and
- 3 persons whose primary business is as a Floor Broker.

The Vice Chairman of the Exchange and the Chairman of the Market Performance Committee will continue to serve on the MTS Committee.

The amendment also provides that one of the nine elected positions on the MTS Committee may be filled by a lessor whose primary business is not as a Market-Maker, DPM Designee, or Floor Broker, and whose primary residence is located within 80 miles of the Exchange's trading floor. This distance is equivalent to the distance requirement for certain off-floor directors under Constitution Section 6.1. Because the MTS Committee meets frequently, it is important that its members reside locally to be available for regular and impromptu meetings.

Further, the proposed amendments to Rule 8.82 provide:

- that no elected member of the MTS Committee may be affiliated with (as defined under Rule 1.1(j)) any other elected member of the MTS Committee.
- that the term of office of elected MTS Committee members will commence at the time of the first regular Board meeting of the calendar year.
- that the Board of Directors is the sole judge of whether or not an MTS Committee member no longer qualifies to serve on the Committee.
- that the Board may remove MTS Committee members for cause.
- that the Vice Chairman, with the approval of the Board, may fill vacancies on the MTS Committee until the first regular Board meeting of the calendar year following the next annual election.

Election/Vote Procedures

With respect to Constitutional provisions relating to the annual election and membership votes, the Board proposes to:

- (8) Adopt new Constitution Section 3.8 to authorize the Board to set a "record date" to determine those members who are entitled to receive notice and to vote in any Exchange election/vote. The record date would be the day preceding the date on which notice of the vote is given, if an

alternate record date is not fixed by the Board. An individual or organization must be an effective, voting member on the record date to cast a ballot in an election or membership vote.

Currently, voting members must have voting rights on the day of the membership meeting. If a member changes membership status after submitting a ballot and proxy, but before the date of the membership meeting, then his/her ballot may no longer be valid. Additionally, a member may obtain voting rights on the day of the membership meeting (e.g., by purchasing a seat or becoming an active (vs. inactive) nominee). The Board believes this amendment is necessary to facilitate an efficient voting process and to allow the Election Committee sufficient time to verify the qualifications of voters.

Upon the approval of the record date provision, the Board is adopting a general practice of issuing an information circular announcing an upcoming membership vote, and the purpose and record date therefor ("Record Date Notice") approximately 7 business days prior to mailing a formal notice and ballot for the vote. The information circular will be mailed to voting members, posted on the CBOE Membership web site, disseminated via the Exchange's broadcast e-mail and fax system, and distributed on the trading floor.⁵ The Record Date Notice will alert members to an upcoming vote and will allow a short period of time for inactive and former members (those who were effective members within the last 6 months) and approved membership applicants to become effective voting members, if they so desire.

- (9) Amend Constitution Section 5.2 to provide that the Exchange may allow voting members to electronically submit ballots and proxies. This amendment would also provide the flexibility to allow for a confidential electronic or on-line voting process in the future, if the Board determines to do so.

Member Notice

With respect to the communication methods by which the Exchange may provide notice to members, the Board proposes to:

- (10) Amend Constitution Section 10.1 to allow the Exchange to give notice to members and associated persons by messenger, courier service, facsimile or electronic mail ("e-mail"), as well as in-person or by mail or telephone as is currently provided in Section 10.1. (The amendment also deletes wireless, telegraph, and cable as available communication methods.) In addition, the Board proposes to amend Section 10.2 to allow for waiver of notice by the same means as notice may be given.

Amending these sections will modernize and make more flexible the Constitutional requirements with respect to notice and waiver of notice.

Currently, the Constitution does not allow the Exchange to provide notice via e-mail or facsimile, unless a member submits a waiver of notice. For example, the Constitution and Rules, in certain specific instances, require the Exchange to provide notice to members. To satisfy these requirements, the Exchange gives notice to members via the *Exchange Bulletin* and the *Regulatory Bulletin*, which are mailed to all effective members unless a members submits a written consent to provision of the *Bulletins* by e-mail.

- (11) Adopt new Constitution Section 10.1(b) which limits the types of notices that may be given via email to only those notices designated by the Board. Constitution Section 10.1(b) will also specifically provide that the Exchange may provide the *Exchange Bulletin* and the *Regulatory Bulletin* (including the notices contained therein) by email. This section also allows the

⁵ The Record Date Notice policy is not subject to the membership vote.

Exchange to permit members and associated persons to request delivery of the *Bulletins* (or such other notices as the Board may designate) by other means, in a form and manner prescribed by the Exchange.

The Board has adopted a policy that, upon the implementation of this Constitutional amendment, the *Exchange Bulletin* and the *Regulatory Bulletin* will be delivered via email. Under this policy, the Exchange will allow a member to specifically request that the *Bulletins* be provided via U.S. Mail. As technology advances, the Exchange could determine at some time in the future to require all members to maintain an email address for receipt of certain notices from the Exchange. No such requirement has been proposed at this time.

The Board endorses email as an efficient and convenient method for providing the *Exchange/Regulatory Bulletin* notices to members. Emailing the bulletins will facilitate more timely communication of Exchange information, as well as cost savings with respect to printing and mailing expenses.

Exchange Employees

- (12) Delete Constitution Section 11.4, which prohibits officers and employees of the Exchange (except the Vice Chairman of the Board) from trading any option listed on CBOE. This section also requires officers and employees to report to the Exchange every purchase or sale of any security underlying an option listed on CBOE.⁶

The above trading restriction and reporting requirement are also set forth in the Exchange's Employee Conflict of Interest Policy. Upon the deletion of Section 11.4, the Board is proposing to liberalize the securities transaction policies to allow employees (with certain restrictions applicable to Regulatory Services Division employees) to trade CBOE listed products and to require employees to report transactions in CBOE listed products to the Exchange. The securities transaction policy would be included solely in the Exchange Employee Handbook, rather than the Exchange's Constitution.⁷ By moving the employee securities transaction policy out of the Constitution and including it only in the Employee Handbook, it will be easier to adjust the policy in the future, if necessary, as circumstances change.

Housekeeping Amendments

- (13) The following proposed amendments are housekeeping in nature and designed to modernize and clarify the Exchange's Constitution and Rules ("Housekeeping Amendments"). They also update the Constitution and rules to reflect current rules and practice. The Board proposes to:
- (a) Amend Constitution Sections 1.1(c) and 2.3 to include the concept of leased memberships, as well as owned memberships, in the definition of member organizations and the requirement that member organizations designate an individual nominee to be consistent with the Constitution's provisions and Exchange rules.
 - (b) Amend Constitution Sections 2.1(a) and 12.1 to add "voting" to the term "members" to clarify who may vote at a membership meeting.

⁶ The Exchange is also filing a rule change to amend Exchange Rule 9.17 to delete the requirement that a member organization must obtain authorization from the CBOE before executing securities transactions for officers or employees of any national securities exchange that is a participant of the Clearing Corporation. The rule will continue to require member organizations to obtain such authorization from the CBOE before executing securities transactions for CBOE officers and employees. This rule change is not subject to the membership vote.

⁷ The employee securities transaction policy in the Employee Handbook is not subject to the membership vote.

- (c) Amend Constitution Section 3.1 to specify that membership meetings will take place on the 4th floor of the Exchange (as opposed to on the trading floor), unless otherwise determined by the Secretary, to conform to current practice.
- (d) Amend Constitution Section 3.2 to provide that the annual election meeting will be held on the 1st business day preceding the 3rd Friday in November (rather than on the 3rd Friday).
- (e) Amend Constitution Sections 3.2 and 3.3 to specify that the Secretary, rather than the Board, will determine the time of the annual election and annual report meetings, because the Board does not generally become involved in this level of detail with respect to membership meetings.
- (f) Amend Constitution Section 3.3 to clarify that the purpose of the annual report meeting is to present the Exchange's annual report.
- (g) Amend Constitution Section 3.5 to specify that written notice of each membership meeting at which a vote will be taken shall be "given" (rather than "delivered") to each member entitled to vote not more than 60 days and at least 10 days before the date of the meeting to be consistent with Delaware law.
- (h) Amend Constitution Sections 4.1 and 6.1 and Rule 8.82 to make it clear whether the term "member" in the eligibility criteria for the Board of Directors, the Nominating Committee, and the MTS Committee is referring to a "member of the Exchange" or a "member of the Board or Committee," as applicable.
- (i) Amend Constitution Sections 4.1 and 4.2 to clarify that a Nominating Committee member's term ends upon the expiration of his/her term or upon the Nominating Committee member's death, resignation or removal.
- (j) Amend Constitution Sections 4.3, 4.6, 5.3 and 8.9 to clarify and make consistent references requiring the posting of information on the Exchange bulletin board.
- (k) Amend Constitution Sections 5.2 and 5.3 to be consistent with the current procedures for the receipt, verification and counting of ballots.
- (l) Amend Constitution Section 6.7 to allow the Exchange to provide notice of a special Board meeting to each Director either in person, by mail, messenger, overnight courier, facsimile machine, e-mail, telephone, or announcement on the Exchange trading floor. The amendment proposes to delete telegram and cablegram as methods of notice to directors for special Board meetings.
- (m) Amend Constitution Section 8.1 to provide that the vote to elect a Vice Chairman of the Board (if any) will be held on the 1st business day preceding the 3rd Friday in December (rather than the 3rd Friday) and to clarify that the Board does not have to reappoint all officers at the beginning of each year.
- (n) Amend Constitution Section 8.4 to clarify, consistent with Constitution Section 8.1(a), that if a vacancy occurs in the office of Chairman, the Board shall appoint a new Chairman by the affirmative vote of at least two-thirds of the Directors then in office.
- (o) Amend Constitution Section 8.6 to specifically allow the Board to grant an exemption to the prohibition against the President engaging in any other business in the same manner that the Board may grant such an exemption to the Chairman of the Board pursuant to Constitution Section 8.2.
- (p) Amend Constitution Sections 8.6, 8.7(b), 8.8, 8.9 and 8.10 to update the Constitution with respect to officer duties and responsibilities (i.e., clarify that the President shall be required to approve all contracts on behalf of the Exchange but may delegate responsibility for executing contracts, specify when the Secretary must maintain records

of meetings, specify that the Chairman of the Board and the President, as well as the Board, may remove any officer, clarify that the President may assign duties to officers, and move the duty to collect all monies due the Exchange from the Secretary to the Treasurer).

- (q) Delete Constitution Section 11.3, which authorizes the Chairman of the Board to establish Exchange departments. The section is unnecessary because the authority is encompassed within the Chairman's responsibility as Chief Executive Officer and inconsistent with the Exchange's current organizational structure, which consists of divisions made up of departments.

Recommendation of the Board of Directors

The Board of Directors believes that these proposed amendments to the Constitution and Rules will further enhance the fair and efficient governance of the Exchange and will modernize various of the Exchange's governance provisions. For this reason, the Board urges all members to vote **FOR** the proposed amendments, and to return the completed Official Ballot and Proxy promptly after you receive them, but no later than the special meeting of the membership on Monday, October 27, 2003.

If you have any questions regarding the proposed amendments to the Constitution and Rules, please contact Patrick Sexton at 312-786-7058 or sexton@cboe.com. If you have any questions regarding the special meeting of the membership, please contact Jaime Galvan, at 312-786-7058 or galvanj@cboe.com.

Encl: Constitution and Rule 8.82 Booklet

Stay informed about issues at CBOE! Sign up today to receive informational and news notices via e-mail or fax. E-mail your name, firm (if applicable) and desired e-mail address or fax number to: members@cboe.com or contact Doug Luzzi at 312-786-7105.