

## **Introduction**

This pamphlet provides a general overview of the regulatory and disciplinary process of the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”). It is intended to provide guidance to CBOE members and associated persons<sup>1</sup> who become involved in Exchange regulatory and disciplinary proceedings as subjects of investigations, subjects of examinations, witnesses or respondents. If you are involved in a regulatory or disciplinary proceeding, you also should review Chapter 17 of the CBOE’s rules for further information.

The CBOE is a national securities exchange registered with the United States Securities and Exchange Commission (“SEC”) that oversees the CBOE’s regulatory and disciplinary process. The CBOE is required under the Securities Exchange Act of 1934 (“Act”) to enforce compliance by its members and their associated persons with the provisions of the Act, its rules and regulations, the rules of the Exchange, and certain rules of the Federal Reserve Board (“FRB”) and the Options Clearing Corporation. The Act also requires the CBOE to discipline its members and associated persons for violations of these rules.

You may be subject to an Exchange regulatory or disciplinary proceeding if you are a CBOE member or associated person. If you are a former CBOE member or associated person, you may be subject to an Exchange disciplinary proceeding if the Exchange notifies you that you are the subject of an investigation within one year after receiving the last written notice of your termination as a member or associated person.

## **CBOE’s Regulatory and Enforcement Structure**

The Exchange’s Business Conduct Committee (“BCC”) is responsible for carrying out the disciplinary functions of the Exchange. The primary roles of the BCC are to determine whether disciplinary proceedings should be initiated and to resolve disciplinary proceedings. The BCC is composed of CBOE members, member firm representatives and other individuals from various segments of the securities industry, as well as one or more public representatives.

The CBOE’s Regulatory Services Group, within the Member and Regulatory Services Division, performs the surveillance, examination, and investigative functions of the Exchange. The Regulatory Services Group consists of the Department of Member Firm Regulation, the Department of Market Regulation, the Department of Regulated Entities, the Department of Information Access and Development and the Department of Regulatory Planning & Strategy.

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<sup>1</sup> An associated person is a partner, officer, director, or branch manager of a CBOE member, a person directly or indirectly controlling, controlled by, or under common control with a CBOE member, or an employee of a CBOE member.

The Department of Member Firm Regulation is responsible for monitoring compliance with CBOE, SEC, and FRB rules related to sales practices of brokerage firms and their associated persons. The Department also is responsible for monitoring compliance with the financial, margin, and books and record keeping requirements of the CBOE, the SEC, and the FRB for broker-dealers over which the CBOE has regulatory responsibility.

The Department of Market Regulation (“DMR”) is responsible for investigating trading-related rule violations, as well as regulatory complaints and referrals from customers, members, the SEC, other exchanges and regulatory bodies, exchange employees, and floor officials. DMR addresses violations related to, among other things, floor broker practices, market maker obligations, and manipulation. DMR also has a Trading Floor Liaison (“TFL”) unit which has a presence on the trading floor and responds to questions from the trading floor concerning Exchange rules and member complaints regarding potential regulatory issues.

The Department of Regulated Entities (“DRE”) oversees the surveillance for the Options Regulatory Surveillance Authority (“ORSA”), the CBOE Stock Exchange (“CBSX”) and the CBOE Futures Exchange (“CFE”). ORSA conducts insider trading surveillance on behalf of six U.S. options exchanges pursuant to a National Market System Plan. CBOE has been chosen as the regulatory services provider for ORSA. CBOE also conducts surveillance for trading activity on CBSX, a facility of CBOE. In addition, DRE oversees the surveillance of the CFE. Most of the CFE surveillances have been allocated to the National Futures Association pursuant to a regulatory services agreement.

The Department of Information Access and Development (“IAD”) is charged with overseeing the Regulatory Services Group’s systems and automation needs.

The Department of Regulatory Planning & Strategy (“DRPS”) was created to enhance the Regulatory Services Group’s interaction with the Exchange’s Systems Division, the Exchange’s Legal Division and the Exchange’s Membership. The primary functions of this Department include: acting as a liaison between the Regulatory Services Group and the Systems Division in the development of automated surveillance procedures; acting as a liaison between the Regulatory Services Group and the Exchange’s Legal Division to evaluate the regulatory impact of proposed rule filings; representing the Exchange’s regulatory interests at certain membership committees both to facilitate communications with the regulatory staff and to communicate about the impact of proposed Exchange rules; and, finally, responding to SEC inquiries and inspection reports regarding the regulatory program. It is also tasked with implementing or facilitating progress toward CBOE commitments to the SEC, Regulatory Oversight Committee and CBOE Board of Directors.

Within the Legal Division, the Office of Enforcement is responsible for resolving disciplinary matters on behalf of the Exchange. The Office of Enforcement negotiates settlements in disciplinary cases for the BCC's consideration. If a respondent in a disciplinary matter does not seek settlement, the Office of Enforcement prepares and presents the case for hearing before the BCC and handles any subsequent appeals.

## **Regulatory Process**

### Investigations and Examinations

Exchange staff may open investigations or examinations of members and associated persons based on information received from a variety of sources, such as surveillance reviews, examinations, industry notifications, and referrals. Anyone may file a written complaint with the Exchange concerning improper conduct by a member or associated person. Complaints should generally be in writing, specifying the allegations in reasonable detail, and signed by the complainant. Upon receiving a complaint, the Exchange sends a letter informing the complainant that an investigation has been initiated and subsequently provides the complainant with periodic status letters. In the early stages of an investigation, the Exchange may not yet have determined which persons are the subjects of the investigation.

It is the Exchange's practice to send the subject periodic letters concerning the status of an investigation. Formal Exchange notices relating to disciplinary proceedings either are delivered to you in person, or sent by registered or certified mail to your address as it appears on the Exchange's records.

If you are a witness or the subject of an Exchange investigation or examination, you may be represented by counsel throughout the investigation or examination (including during an interview). If you are a Respondent in any subsequent Exchange disciplinary proceeding, you may be represented by counsel throughout that proceeding. However, the Exchange will not appoint or provide counsel for you. You may represent yourself, if you choose. If the same counsel represents both you and the firm that employs you, that counsel may have a conflict of interest, and you may wish to obtain separate counsel.

You are required to cooperate with the Exchange in the course of any inquiry, investigation, examination, hearing, or appeal by providing all information requested by the Exchange. If you impede, delay, or fail to cooperate with the Exchange, or make a false statement or misrepresentation to the Exchange, you may be disciplined for those actions.

During the course of an investigation or examination, Exchange staff may interview you, as well as other witnesses. Prior to any interview, staff will inform you of the general purpose of the interview. The Exchange makes a record of each interview. Testimony or material provided to the Exchange during an interview may be used in a disciplinary proceeding brought by the CBOE, another exchange, or a regulatory body. At the conclusion of an interview, you will have the opportunity to make a statement concerning the matters discussed.

## **Resolution of Investigations and Examinations**

Following an investigation or examination, Exchange staff makes an internal report of its findings. If staff concludes that rules have not been violated, generally no further action will be taken. Staff will notify you of this conclusion if you are a subject of the investigation or examination, and will notify the complainant, if any. Even if Exchange staff concludes there has been a violation of Exchange rules and recommends that the BCC initiate disciplinary proceedings, the BCC, upon its review, may decide that no further action should be taken.

If either disciplinary or non-disciplinary regulatory action is taken, the investigation or examination will be resolved in one of the following ways:

### **Non-Disciplinary Regulatory Action**

Letter of Information	(See Below)
Letter of Caution	(See Below)
Staff Interview	(See Below)

### **Disciplinary Action**

Expedited Proceedings	(See Page 5)
Summary Proceedings	(See Page 6)
Settlement	(See Page 6)
Hearings	(See Page 7)

### **Non-Disciplinary Regulatory Action**

A Letter of Information advises you of alleged technical deficiencies in compliance with a rule or rules. A Letter of Caution may be issued when it appears that you have committed non-material rule violations and it appears that a Letter of Caution will be sufficient to prevent a recurrence. A Letter of Caution also notifies you that a subsequent similar violation may result in a disciplinary proceeding. A Staff Interview is a meeting between you and Exchange staff concerning the rule or rules that you allegedly have violated. Staff Interviews generally are used when it is your first alleged violation, and it is deemed that an educational effort will prevent an occurrence of similar violations. Staff keeps a written record of each Staff Interview.

### **Notice and Your Opportunity to Respond**

Following an investigation or examination, if Exchange staff finds there are reasonable grounds to believe there has been a violation of Exchange rules, staff generally will provide you with written notice (“Notice”) stating the general nature of the allegations and identifying the rules that you allegedly have violated. The Notice is sent to you before staff submits its investigative findings to the BCC.

Generally, you have 15 days from the date of the Notice to submit a written statement and/or a videotaped response to the BCC explaining why you believe no disciplinary action should be taken (“Response”). Any videotaped response is limited to fifteen minutes. The Response is your only opportunity, before the BCC decides whether to authorize charges, to explain to the BCC why they should not take disciplinary action against you. Disciplinary action may be serious and may result in significant sanctions. In addition, your disciplinary record will be affected by any disciplinary sanction.

To assist you in preparing your Response, you may have access to only those materials in the Exchange’s file that were furnished by you or your agents, including a copy of your interview. If after reviewing any Response you have submitted, staff still believes that a violation of Exchange rules occurred, staff will provide the BCC with its investigative or examination report along with your Response.

## Disciplinary Process

### Expedited Proceedings

Once you have received a Notice, you may seek to resolve the matter through Expedited Proceedings. In order to do this, you must notify Exchange staff in writing within 15 days of the date of your Notice, of your intention to proceed in an expedited manner. Additionally, you must reach agreement with staff on a letter of consent that sets forth a stipulation of facts and findings concerning your conduct (in which you neither admit nor deny the violations alleged), the rule violations, and a sanction. The letter of consent is submitted to the BCC for its consideration, and if accepted, becomes a final decision. If the BCC rejects the letter of consent, the matter proceeds as though you never engaged in Expedited Proceedings.

### Statement of Charges

The BCC reviews staff’s investigative or examination report and your Response, if you have submitted one. If the BCC decides there is probable cause<sup>2</sup> for finding a rule violation, the BCC authorizes the issuance of a statement of charges against you, and you are considered a respondent.<sup>3</sup> The statement of charges specifies the acts you allegedly have committed and the rules you allegedly have violated.

You have 15 days after the issuance of a statement of charges to file a written answer to the charges.

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<sup>2</sup> Probable cause is defined as a reasonable ground for belief that a violation has occurred. More specifically, the standard requires that there be sufficient evidence to cause a reasonable person, after careful deliberation, to believe the respondent is guilty of the alleged improper conduct.

<sup>3</sup> A respondent is a party who must answer to disciplinary charges authorized by the BCC.

The answer must specifically admit or deny each allegation contained in the charges. Any allegation you do not deny in the answer will be considered admitted. Failure to file an answer is considered an admission of the charges.

After a statement of charges has been issued against you, you may have access to all documents concerning your case that are in the investigative or examination file, except for staff reports or other privileged materials. Staff may protect the identity of a complainant in providing access to the investigative or examination file. To obtain access to the Exchange's investigative file, you must make a written request to staff within 60 calendar days after the statement of charges was issued. You may not communicate with any member of the BCC concerning the substance of a pending Exchange disciplinary proceeding.

### Summary Proceedings

If you fail to file an answer or you admit to any allegations contained in the statement of charges, the BCC may make a summary decision that you have committed rule violations, and it may impose a sanction for those violations. You have 10 days from the issuance of a summary decision to request a hearing on the sanction or on any allegations not admitted. Failure to request a hearing constitutes an admission of the violations, acceptance of the sanction, and waiver of all rights of appeal.

### Offer of Settlement

After a statement of charges is issued, you may resolve an Exchange disciplinary matter through an offer of settlement in which you neither admit nor deny the violations alleged in the statement of charges. Generally, you have a 120-day settlement period following the date that charges are issued,<sup>4</sup> during which you may submit two offers of settlement. A third offer may be submitted during that period provided it is consistent with the BCC's recommended settlement. Your offer must contain a stipulation of facts and findings and a consent to a specified sanction. You may submit a written statement in support of your offer. Exchange staff usually will make a recommendation to the BCC whether to accept or reject your offer.

If Exchange staff does not recommend acceptance of your offer of settlement, you or your counsel may make a personal appearance before the BCC in support of your offer. If staff does recommend acceptance of your offer and the BCC rejects it, then you or your counsel may make a personal appearance before the BCC in support of your offer. At a personal appearance, you may not contest the facts and rule violations that are stipulated in your offer. Rather, your personal appearance is an opportunity to explain why your offer is appropriate and should be accepted. For example, you may discuss penalties imposed in similar cases, restitution made, mitigating factors, or other extenuating

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<sup>4</sup> If you elect to proceed under expedited proceedings and are unable to reach an agreement with Exchange staff, the number of days exceeding 30 days spent in expedited proceedings is deducted from the 120 day settlement period. However, you never will have less than a 14 day settlement period.

circumstances. The BCC may require that facts presented during your personal appearance be substantiated with documents or other information.

If the BCC accepts your offer of settlement, it issues a decision containing findings, conclusions, and a sanction, consistent with the terms of your offer. The decision is final and you have no opportunity to appeal. If the BCC does not accept any of your offers of settlement, and the 120-day settlement period expires, or you choose not to submit an offer of settlement, a disciplinary hearing will be scheduled.

## Hearings

You will be given at least fifteen days notice of the time and place of your hearing. At least five business days before the scheduled hearing date, you and Exchange staff must furnish the hearing panel and the other parties with a witness list and copies of all documentary evidence to be presented at the hearing.

The parties may have a pre-hearing conference to clarify and simplify issues, and if possible, to reach an agreement regarding the authenticity of documents, facts not in dispute, and any other items that will expedite the hearing process. The hearing panel or its chairperson will decide unresolved pre-hearing issues at either party's request.

CBOE hearings are conducted in a manner similar to a courtroom trial, but without rigid court rules. Each party may make an opening statement, present evidence and witnesses, conduct direct and cross examination of witnesses, and make a closing argument. Exchange staff has the burden of proving by a preponderance of the evidence<sup>5</sup> that you committed the violations alleged in the statement of charges. Generally, hearings are presented to a panel of at least three members of the BCC. The panel regulates the conduct of the hearing and determines all questions concerning the admissibility of evidence. The panel may request that you produce documentary evidence and witnesses, and panel members may ask questions of the witnesses and the parties. A record is made of each hearing.

Following the hearing, the panel reviews all of the evidence admitted and presents its findings to the BCC. The BCC may ratify, reject, or modify these findings. The BCC will find against you if Exchange staff has proven the allegations by a preponderance of the evidence. If staff has not met its burden, the BCC will find in your favor. The BCC issues a written decision to you that includes a discussion of the facts and circumstances of the case, the findings and conclusions of the BCC, including the BCC's reasoning and the sanction, if any.

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<sup>5</sup> Preponderance of the evidence is defined as evidence which is of greater weight or more convincing than the evidence which is offered in opposition to it; that is, evidence which as a whole shows the fact to be proved to be more probable than not.

## Sanctions

Sanctions in disciplinary proceedings may include one or more of the following: censure; fine; limitation of activities, functions or operations; suspension or bar from CBOE membership; suspension or bar from association with CBOE members; or any other fitting sanction, including undertakings to take specified future actions. In imposing a sanction, the BCC considers, among other things, the seriousness of the offense, prior similar cases, and your prior disciplinary history. The BCC generally does not award monetary damages to a complainant as part of a sanction. As discussed later in this pamphlet, arbitration may be the more appropriate forum for a complainant to seek monetary compensation for injury or other relief.

A sanction will not take effect until the Exchange's review process is completed. Following is a brief description of the various forms of sanctions the BCC may impose.

### Censure

The BCC may impose a censure if you have committed a violation and the BCC wishes to express a judgment of disapproval as to your actions.

### Fine

There is no limit on the amount of a fine, other than the general consideration that a sanction may not be arbitrary, capricious, or a clear abuse of discretion.

### Limitation of Activities, Functions, or Operations

The BCC may restrict you in your activities as a member or associated person. For example, a member firm might be restricted with respect to the activities it conducts in certain branch offices. A floor member might be prohibited from functioning as a market maker or floor broker, or prohibited from opening new positions as a market maker.

### Suspension or Bar

- A suspension denies you the rights and privileges of membership for a specific period of time.
- A bar prohibits you from acquiring the rights and privileges of membership for a specific period of time or indefinitely.
- A suspension or bar from association with members precludes you from being associated with any CBOE member for a specific period of time.

### Undertakings

An undertaking requires you to perform specified activities. For example, an associated person may be required to take and pass a securities industry exam, or a member firm may be required to hire an independent auditor to review the firm's supervisory or compliance procedures.

## **Appeal of Disciplinary Actions**

BCC decisions based on offers of settlement or letters of consent are final and may not be appealed. BCC hearing decisions may be appealed to the Exchange's Board of Directors ("Board").

You have 15 days after issuance of a BCC hearing decision to petition in writing for review of that decision. It is important that you specifically object in your petition to each finding and conclusion to which you take exception, and that you include the reasons for your objections. If you fail to state an objection in your petition, it is considered abandoned. Exchange staff may submit a response to your petition and you are given fifteen days to reply to staff's response.

The Board usually conducts its review based on the record of the hearing and the information submitted by the parties. It generally does not hear oral argument or accept new evidence. The Board may affirm, reverse, or modify any part of the BCC decision. Exchange staff may not appeal a BCC decision or the sanction. However, the Board on its own initiative may order review of a BCC decision involving a disciplinary hearing or summary proceedings.

You may appeal a Board decision to the SEC. However, you must apply to the SEC separately to delay the effectiveness of a CBOE sanction while the SEC is reviewing your appeal. The SEC may uphold the Board decision, set it aside, or modify it. The SEC also may remand the matter back to the CBOE for further review. You may appeal the SEC's decision to the United States Court of Appeals, and ultimately request review by the United States Supreme Court.

## **Dissemination of Exchange Decisions**

Disciplinary decisions are publicly available and maintained by the Office of Enforcement. A disciplinary decision is not available to the public until the Exchange's appeal process has been completed or the time for appeal has expired. Disciplinary decisions are available on the Exchange's website at [www.cboe.com](http://www.cboe.com).

The Exchange summarizes all final Exchange disciplinary decisions, except dismissals, in the Exchange's Regulatory Bulletin. Each summary includes the name of the member or associated person that is named in the decision, a brief description of the material facts, the rules violated, and the sanction.

The Exchange reports to the Central Registration Depository (CRD) through WebCRD the following information concerning formal disciplinary proceedings: the name of the respondent; the fact that a statement of charges was issued; a summary of the charges; and all other significant changes in the status of the disciplinary proceeding while it is pending, such as the scheduling of a disciplinary hearing, the issuance of a decision by the BCC, the filing of an appeal to the Board, and the issuance of a decision by the Board. The Exchange is required to file all final disciplinary decisions with the SEC.

Further, a disciplinary decision becomes part of the respondent's disciplinary record and may be considered in any future action brought by the Exchange.

It is the Exchange's policy to issue a press release when a disciplinary action involves a suspension or bar from membership or association with a member, or when a violation is deemed to significantly affect investors.

When a decision involves a suspension or bar of a trading floor-related member or individual, the Membership Department posts the name of the barred or suspended individual and the term of the suspension on the Exchange's 4th floor bulletin board

### **Reporting Requirements**

A broker-dealer is required to report timely on SEC Form BD all statements of charges and final disciplinary decisions issued to the broker-dealer or its associated persons (except for certain "minor rule violations" as explained below). A person who maintains any securities industry registrations is required to report timely on Form U-4 (Uniform Application for Securities Registration or Transfer) all statements of charges and final disciplinary decisions issued to that person, and also may be required to report timely on Form U-4 complaints or investigations involving the person after the Notice has been issued. It is your or your firm's obligation to amend Form BD and/or Form U-4.

#### **Minor Rule Violations**

In lieu of commencing a formal disciplinary proceeding, the Exchange may impose a summary fine of not more than \$5,000 for violations set forth under Exchange Rule 17.50- Imposition of Fines for Minor Rule Violations. A summary fine may be appealed.

There is no obligation to report a summary fine on Form BD if the fine is not contested and does not exceed \$2,500. However, disclosure of the fine may be required on other securities industry forms or membership applications. In addition, the CBOE reports all summary fines to the SEC, except floor decorum fines that are not contested and are not more than \$1,000.

### **Arbitration**

The CBOE sponsors an impartial arbitration forum for the resolution of disputes arising out of Exchange business. Arbitration is a means for a complainant to seek recovery of damages, demand performance of an agreement, or obtain other appropriate relief. Determinations are made by neutral arbitrators who are knowledgeable about the securities industry. The forum is independent of the Exchange's regulatory and enforcement areas. A finding by the BCC of a violation of Exchange rules or federal securities laws is not a prerequisite to recovery in arbitration. A packet of information concerning the arbitration process is available from the Exchange's Arbitration Department.

## **Appeal of Other Actions**

Exchange members and certain other persons and organizations, such as applicants for membership, who are economically harmed by a non-disciplinary Exchange action, generally may appeal the action to the Exchange's Appeals Committee. Examples of non-disciplinary actions that may be appealed include, but are not limited to: (1) being denied membership; (2) being barred from becoming an associated person; or (3) being prohibited or limited with respect to Exchange services. A decision of the Appeals Committee may be appealed to the Board. For a detailed description of the CBOE appeals process, see Chapter 19 of the CBOE rules.

## **CBOE Offices**

Further information concerning Exchange rules and disciplinary procedures may be obtained by contacting the Exchange departments listed below.

Arbitration Department  
(312) 786-7031

Department of Member Firm Regulation  
(312) 786-7713

Department of Market Regulation  
(312) 786-7844

Department of Regulated Entities  
(312) 786-7752

Office of Enforcement  
(312) 786-7483

Trading Floor Liaison  
(312) 786-7939

Office of Corporate Secretary  
(312) 786-7462

This pamphlet is an overview of the Exchange's disciplinary process and should serve only as a supplement to careful review of relevant Exchange rules and federal securities laws. The description of the Exchange's disciplinary process contained in this pamphlet is current through January 2008. Therefore, any amendments to Exchange rules since that date are not reflected in this pamphlet. However, to view the current CBOE's Constitution and Rules or Exchange Regulatory Circulars, please visit our website at: [www.cboe.com](http://www.cboe.com).