



**Regulatory Circular RG03-61**

**Date:** July 24, 2003

**To:** Members, Applicants for Membership, and  
Persons Associated with Members

**From:** Legal Division

**Re:** Statutory Disqualifications

Definition of Statutory Disqualification

Pursuant to Section 3(a)(39) of the Securities Exchange Act of 1934 ("Act"), a person is subject to a statutory disqualification if, among other things, the person:

- (i) has been convicted within the preceding 10 years of any felony;
- (ii) has been convicted within the preceding 10 years of any misdemeanor involving a securities transaction, the securities business, the making of a false report, bribery, perjury, burglary, or the misappropriation of funds or securities;
- (iii) is barred or suspended from membership in a self-regulatory organization ("SRO") or from being associated with a member of an SRO;
- (iv) is barred or suspended by the Securities and Exchange Commission ("SEC") or the Commodity Futures Trading Commission;
- (v) is barred by a state securities or insurance authority or a federal or state banking authority;
- (vi) is enjoined from any action, conduct, or practice in connection with the securities or commodities industry or securities or commodities transactions;
- (vii) has willfully violated federal securities or commodities law or aided, abetted, or counseled others to do so; or
- (viii) has willfully made in any application, report, or proceeding of an SRO a false or misleading statement as to a material fact or has willfully omitted to state a material fact that was required to be stated in any such application, report, or proceeding.

### Members Who Become Subject to a Statutory Disqualification

If a member is or becomes subject to a statutory disqualification and wants to continue in membership, the member must, within 10 days of becoming subject to the statutory disqualification, submit an application to the Membership Department pursuant to CBOE Rule 3.18 seeking to continue in membership notwithstanding the statutory disqualification. The application consists of the completion of a Form U-4 for information gathering purposes, including applicable disclosure reporting pages, and should be accompanied by copies of all documents that are contained in the record of the underlying proceeding that triggered the statutory disqualification. The Membership Department may also request other information from the member and from any other member or associated person in connection with the proceeding. Failure to timely file such an application is a factor that may be taken into consideration by the Membership Committee in rendering its decision with respect to the application.

Following the receipt of the application, or in the event the Exchange becomes aware that the member is subject to a statutory disqualification and has not timely submitted an application, a three person panel of the Membership Committee holds a hearing to determine whether to permit the member to continue in membership, and if so, whether to condition such continuance in membership. The member is required to attend the hearing. The panel may also request information from the member and require any other member or associated person to provide information or to testify at the hearing. During the hearing, the member and Exchange staff are afforded an opportunity to present relevant information, arguments, and witnesses. The panel regulates the conduct of the hearing, and formal rules of evidence do not apply.

Following the hearing, the panel presents its recommended decision to the Membership Committee, which may ratify or amend the decision. The Executive Committee may determine within 7 days after issuance of the Membership Committee's decision to the member to order review of the decision pursuant to Rule 3.18(h). If the Executive Committee does not order review of the Membership Committee's decision, the Membership Committee's decision becomes the final decision of the Exchange. If the Executive Committee orders review of the decision, the decision of the Executive Committee with respect to that review is the final decision of the Exchange. No determination of the Membership Committee to discontinue or condition the membership of a member pursuant to Rule 3.18 takes effect until the above review procedures have been exhausted or the time for review has expired.

### Applicants for Membership Who Are Subject to a Statutory Disqualification

Under CBOE Rule 3.5(b), the Membership Committee may deny membership, or grant only conditional membership, to any applicant for membership that is subject to a statutory disqualification.

Before making any determination with respect to a membership applicant that is subject to a statutory disqualification, the Membership Committee appoints a File Review Subcommittee of the Membership Committee to review the matter. The Subcommittee reviews any application materials submitted by the applicant. Pursuant to CBOE Rule 3.9(i), the Subcommittee may request from the applicant and associated persons of the applicant any additional information that the Subcommittee deems relevant. Following the Subcommittee's review of any application materials and any additional requested information, the Subcommittee conducts an in-person interview of the applicant and may conduct in-person interviews of other persons associated with the applicant, such as the applicant's supervisor(s). The Subcommittee briefs the Membership

Committee regarding the matter. The Membership Committee also conducts an in-person interview of the applicant. Additionally, the Membership Committee may interview other persons associated with the applicant and may request additional information from the applicant that the Membership Committee deems relevant.

Any applicant that is denied membership or granted only conditional membership may appeal the Membership Committee's decision to the Appeals Committee pursuant to Chapter XIX of the Exchange's rules, and may appeal the Appeals Committee's decision to the Board of Directors pursuant to CBOE Rule 19.5.

#### SEC Approval Process

In the event that (i) the Membership Committee decides that a member that is subject to a statutory disqualification should continue in membership or association with a member, (ii) the Membership Committee approves the membership application of an applicant that is subject to a statutory disqualification, or (iii) the Membership Committee does either of the foregoing subject to specified conditions placed on the effected member or applicant (such as a limitation on activities or functions), any such decision is subject to the approval of the SEC. Specifically, SEC Rule 19h-1 requires that in order for a person who is subject to a statutory disqualification to continue in membership or association with a member, or be admitted to membership or association with a member, the Exchange must request SEC approval of that action by submitting a Rule 19h-1 filing to the SEC and the SEC must approve the action.

A Rule 19h-1 filing is an extensive filing which is required to set forth various information concerning the person that is the subject of the filing, the person's statutory disqualification, and the firm, if any, with which the person is associated or intends to associate. In addition, if the person that is the subject of the filing is associated or intends to associate with a firm that is a member of both the Exchange and another SRO, the SEC takes into consideration whether the other SRO concurs with the Exchange's request to continue such person in Exchange membership or to admit such individual to Exchange membership, as applicable, in determining whether to grant the Exchange's request.

The status of a person who is subject to a statutory disqualification and on whose behalf the Exchange determines to make a Rule 19h-1 filing remains unchanged during the Rule 19h-1 filing process. Thus, an applicant for Exchange membership that is subject to a statutory disqualification may not become a member of the Exchange unless and until the SEC approves the Rule 19h-1 filing made by the Exchange on the person's behalf. Similarly, as long as a member who is subject to a statutory disqualification otherwise remains a member of the Exchange in good standing, the member is permitted to remain as an Exchange member pending the SEC's determination as to whether to approve the Rule 19h-1 filing made by the Exchange on the member's behalf.

#### Associated Persons Who Become or Are Subject to a Statutory Disqualification

The above-described rules and procedures apply to any person associated with an Exchange member and to any person applying to become associated with an Exchange member in the same manner that they apply with respect to Exchange members and applicants for Exchange membership.

The Exchange may waive the provisions of Rule 3.18 when a proceeding is pending before another SRO to determine whether to permit an associated person of a member to continue in membership or association with the member notwithstanding a statutory disqualification. In the event the Exchange determines to waive the provisions of CBOE Rule 3.18 with respect to an associated person, the Department of Financial and Sales Practice Compliance determines whether the Exchange will concur in any Rule 19h-1 filing made by another SRO with respect to the associated person. The Department of Financial and Sales Practice Compliance also ordinarily determines whether to concur in a Rule 19h-1 filing made by another SRO with respect to an associated person applicant.

#### Exchange Fees Applicable to Those Who Are Subject to a Statutory Disqualification

The Exchange assesses a \$2,750 fee whenever a person or entity that is subject to a statutory disqualification (i) is an applicant for Exchange membership, (ii) is seeking to be an associated person of an Exchange member (except where the Exchange is merely asked to concur in a Rule 19h-1 filing by another SRO) or (iii) is an existing Exchange member or associated person who makes an application in accordance with Rule 3.18(b) or with respect to whom a proceeding is initiated pursuant to Rule 3.18. This fee is in addition to any other membership fees that might be applicable.

In addition, the Exchange assesses a \$1,650 fee whenever a person or entity on whose behalf the Exchange has filed a Rule 19h-1(c) filing that has been approved by the SEC applies for a change in status that will require the Exchange to file an amended or additional Rule 19h-1(c) filing if the Exchange approves the requested change in status. This fee is also in addition to any other membership fees that might be applicable.

#### Reporting Requirements

If an associated person of a member is or becomes subject to a statutory disqualification, the member is required to immediately provide written notice to the Membership Department of the name of the associated person, the person's capacity with the member, and the nature of the statutory disqualification.

In the event that a member is a registered broker-dealer and the member or an associated person of the member (i) becomes subject to an event that gives rise to a statutory disqualification or (ii) becomes the subject of a proceeding that could result in an event that gives rise to a statutory disqualification, the member is required to report the event by promptly filing an amendment to SEC Form BD.

In addition, in the event that a person maintains any securities industry registrations (e.g., is a registered representative or registered options principal) and the person (i) becomes subject to an event that gives rise to a statutory disqualification or (ii) becomes the subject of an investigation, regulatory complaint, or proceeding that could result in an event that gives rise to a statutory disqualification, the person is required to report the event by promptly filing an amendment to Form U-4.

Any questions regarding this circular may be directed to Arthur Reinstein at (312) 786-7570.

(Regulatory Circular RG98-45, Revised)