Principal Traders Group

December 3, 2013

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: SR-CBOE-2013-100

Dear Ms. Murphy:

The Futures Industry Association Principal Traders Group ("FIA PTG") appreciates the opportunity to comment on the above referenced proposed rule filing by the Chicago Board Options Exchange, Incorporated ("CBOE"). FIA PTG is composed of firms that trade their own capital on the U.S. futures and equities exchange markets. FIA PTG members engage in manual, automated, and hybrid methods of trading, and are active in a variety of asset classes, such as foreign exchange, commodities, fixed income, and equities. FIA PTG membership includes firms registered as broker-dealers many of whom are registered as designated market makers on various national securities exchanges. FIA PTG member firms are direct participants on equities and options markets, including CBOE and its stock execution facility, CBOE Stock Exchange, LLC ("CBSX"). FIA PTG member firms serve as a critical source of liquidity to U.S. markets, allowing those who use such markets to manage their business risks by allowing them to enter and exit markets efficiently.

FIA PTG seeks to comment on the proposed rule change, filed by CBOE with the Securities and Exchange Commission (the "Commission") on November 5, 2013, concerning proposed CBOE Rule 50.4A, CBSX Trading Permit Holder Eligibility (the "Proposed Rule").[1]

[1] The Proposed Rule, along with all other rules governing CBSX, are contained in Chapter L of CBOE's Rules.

While FIA PTG understands that this proposal has been made pursuant to CBOE's compliance efforts in response to deficiencies in CBOE practices noted by the Commission, and while FIA PTG supports CBOE's efforts to ensure compliance with SEC directives; for the reasons outlined below, FIA PTG believes that the Commission should not approve the Proposed Rule as: (i) it violates the Securities Exchange Act of 1934 (the "Act"); (ii) it is costly and burdensome without commensurate benefit to the market; and (iii) there is a simpler, more direct, and less burdensome alternative to achieve the same result.

Background

As mentioned above, CBSX is the stock execution facility of CBOE. It is not an independent exchange, but forms part of CBOE and is regulated by CBOE. According to CBOE, regulatory monitoring of CBOE is done via collaboration with the Financial Industry Regulatory Authority ("FINRA") on common issues and areas of concern,[2] and by CBOE as a member of the Intermarket Surveillance Group ("ISG").

CBOE, and likewise CBSX, is subject to the Commission's June 11, 2013 Order Instituting Administrative and Cease-and-Desist Proceedings (the "Order") that included several undertakings designed to remediate certain violations of the Act by CBOE that the Commission noted in the course of an investigation of CBOE activities.

One particular undertaking that spurred CBOE to submit the Proposed Rule, is Undertaking O (the "Undertaking"). The Undertaking requires that:

> CBOE…enhance its regulation of *CBSX-only trading permit holders* by developing and implementing a regulatory plan to enforce all applicable federal securities laws and regulations and CBSX rules, including but not limited to the anti-fraud rules, regardless of trading venue. (emphasis added).

As CBOE noted in its filing with the Commission, the Undertaking concerns "CBSX-only trading permit holders, i.e., Trading Permit Holders that are not CBOE Trading Permit Holders or members of another national securities exchange or national securities association…"[3] However, the Proposed Rule would apply to any CBSX Trading Permit Holders, many of which are CBOE Trading Permit Holders or members of another national securities exchange. Many of these national securities exchanges outsource their examination and surveillance obligations to FINRA, who is currently the only registered national securities association.

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[2] *See* CBSX presentation dated September 14, 2013, available at <http://www.cbsx.com/Regulation/CBSXRegProgram091310.pdf>.
[3] *See* CBOE filing SR-CBOE-2013-100, footnote 1.

Analysis

A. The proposed Rule does not conform to Section 6(b)(2)[4] of the Act.

As other commentators have noted, because the proposed Rule would not allow any broker-dealer, or more specifically a non-FINRA member broker-dealer, to become a member of CBSX it does not conform to Section 6(b)(2) of the Act.[5] In relevant part, the Act reads:

> "An exchange shall not be registered as a national securities exchange unless the Commission determines that –
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> > (2) Subject to the provisions of subsection (c) of this section, *the rules of the exchange provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof.*" (emphasis added).

Section 6(c) of the Act[6] provides the basis for denial of membership to a national securities exchange, and in relevant part, the basis for denial of membership is: (i) failure to register as a broker-dealer; (ii) statutory disqualification; or (iii) failure to meet standards of financial responsibility or operational capacity, or a showing that the party has or that there is a reasonable likelihood that they may engage in acts or practices inconsistent with just and equitable principles of trade.

As stated by CBOE, the proposed Rule would impact 42 CBSX Trading Permit Holders[7], each of which is a duly registered broker-dealer. Nowhere in Section 6(C) does the Act allow for an exchange to deny membership to a duly registered broker-dealer solely on the basis that it is not a member of a registered national securities association (i.e., FINRA).

CBOE notes in its submission that the proposed Rule is "consistent with the Act…and, in particular, the requirements of Section 6(b) of the Act," however, CBOE's analysis of Section 6(b) is limited to subsection 6(b)(5) and appears to wholly ignore subsection 6(b)(2). While CBOE explains in some detail its justification for the proposed Rule under subsection 6(b)(5), in order to satisfy Section 6(b) of the Act, a national securities exchange must satisfy all of the subsections of 6(b), which the Proposed Rule does not. No matter the detail provided as an explanation under one subsection of Section 6(b),

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[4] 15 U.S.C. 78f(b)(2).
[5] *See* Comment letter dated November 11, 2013from Vitru Financial BD LLC on CBOE filing SR-CBOE-2013-100.
[6] 15 U.S.C. 78(c).
[7] *See* CBOE filing SR-CBOE-2013-100, footnote 9.

CBOE's proposed Rule cannot escape the obligation to satisfy the other subsections of Section 6(b) like all other national securities exchanges, which it plainly fails to do.

Thus, because the proposed Rule denies membership to registered broker-dealers in violation of Section 6(b)(2) of the Act, and Section 6(c) of the Act does not allow for the denial of membership that would otherwise be permitted by Section 6(b)(2) of the Act, the Proposed Rule is in direct violation of the Act.

B. The Rule will result in great costs (both monetary and otherwise) to the affected firms, and these costs greatly surpass the benefit to the market(s).

The Proposed Rule would require CBSX Trading Permit Holder firms who do not transact customer business to obtain FINRA membership at significant expense to such firms. FINRA membership has traditionally been reserved for broker-dealers that transact business with customers by way of FINRA's authority as a regulator of the over-the-counter market, a purpose that is not applicable to CBSX Trading Permit Holder firms that do not transact customer business.

In its submission CBOE implies that membership with FINRA is a matter of minimal inconvenience for affected firms. Unfortunately, however, this is far from reality, as undertaking FINRA membership is a significant, time-consuming, and expensive exercise. In fact, FINRA warns potential applicants that "[s]ubmitting a FINRA membership application is a serious undertaking and should be considered carefully."[8] It goes on to recommend that applicants, "consider alternatives to applying for membership."[9] In all, the FINRA membership process can take over six months, sometimes even lasting 18 months or more.

Obtaining FINRA membership would also require firms to review and analyze the applicability of a vast array of rules and interpretations from FINRA that they were previously not subject to – the majority of such rules and interpretations are designed to apply to firms with FINRA's membership base in mind – those firms who transact customer business. Thus, much of this effort would involve to some degree an expensive exercise in form over substance. Moreover, becoming a FINRA member would require firms to amend filings with all other exchanges, thereby incurring additional unnecessary filing costs. In addition, assuming the FINRA registration process were successful, the impacted firms would be required to acquire a fidelity bond. FINRA Rule 4360 requires each FINRA member firm that is a registered broker-dealer to maintain blanket fidelity bond coverage with specified amounts of coverage based on the firm's net capital requirement. The absolute minimum coverage amount permitted under

[8] *See* FINRA webpage on how to become a member; available at: <http://www.finra.org/Industry/Compliance/Registration/MemberApplicationProgram/HowtoBecomeaMember/index.htm>.
[9] *See Id.*

FINRA Rule 4360 is $100,000, while the requirement can be as high as $5,000,000. The fidelity bond requirement is designed to insure a firm against intentional fraudulent and dishonest acts that typically would involve the theft of customer funds or acts involving customers' accounts. As the firms impacted by the Proposed Rule do not transact customer business, it is difficult to understand the benefit that the fidelity bond requirement would have, but it is not difficult to understand the unnecessary added costs associated with the fidelity bond.

Beyond basic monetary considerations, becoming a FINRA member has the added costs associated with reporting to FINRA's Order Audit Trail System ("OATS"). While non-FINRA member registered broker-dealers have an OATS recordkeeping obligation, they are relieved from the technically challenging, time-consuming, and expensive OATS reporting obligations unless FINRA specifically asks for such data. This OATS reporting obligation has been described as onerous and "not offset by an equivalent regulatory benefit,"[10] as it would apply to broker-dealers that do not transact customer business. Moreover, the imposition of OATS reporting on non-customer facing broker dealers would simply duplicate OATS reporting already provided by other FINRA member firms. It seems unlikely that CBOE considered this significant burden on CBSX Trading Permit Holder firms when is submitted the Proposed Rule.

Besides the burdens associated with becoming a FINRA member, FINRA membership also would subject CBSX Trading Permit Holder firms and their associated persons to new and noteworthy regulatory obligations. For example, individuals who are associated with CBSX Trading Permit Holders who possess the Series 56 may be required to complete the Series 7 because FINRA currently does not recognize the Series 56. Additionally, because FINRA does not recognize the Series 56, those principals who obtained the Series 24 based on the prerequisite of completing the Series 56 would no longer possess a valid Series 24 as FINRA only recognizes the Series 7 as a basis for the Series 24 for those who transact business in equity securities.[11]

The New York Stock Exchange ("NYSE") provides an excellent example of the consequences and costs associated with requiring FINRA membership for member firms who do not transact customer business. In October 2007, due to a consolidation of regulatory functions which led to the creation of FINRA, NYSE changed its rules to require FINRA membership for all member firms.[12] However, in June 2009 NYSE eliminated the FINRA membership requirement for its member firms that do not transact

[10] *See*, Securities Exchange Act Release No. 34-56096 (July 18, 2007), 72 FR 40917 (July 25, 2007) (Order approving SR-NASDAQ-2007-037).
[11] It also seems unlikely that a waiver of the Series 7 requirement would be possible, so firms could then have a situation where principals without a Series 7 would be supervising associated persons with a Series 7.
[12] *See* NYSE filing SR-NYSE-2007-67.

customer business so long as they are a member of another registered securities exchange.[13] In eliminating the FINRA membership requirement NYSE stated that such change was consistent with the rules of other registered national securities exchanges and that the change would not sacrifice regulatory oversight.[14] Additionally, the practical commercial impact of requiring FINRA membership was that most principal trading firms did not view NYSE membership as a possibility primarily because of the requirement to become a FINRA member. Now that the NYSE has amended its rules to be more inclusive, many principal trading firms, i.e., those firms who provide a significant source of liquidity to the markets, are now NYSE members.

The NYSE example stands in stark contrast to the Proposed Rule not only with respect to the likely commercial impact on the market and CBSX Trading Permit Holders, but, if the Proposed Rule goes into effect, CBSX would be the only exchange requiring FINRA membership for member firms that do not transact customer business yet are members of another national securities exchange. The Proposed Rule, therefore, would position the CBSX as an outlier and subject to possible regulatory arbitrage which could increase market fragmentation.

C. It is more appropriate for CBOE to obtain what they require to enforce federal rules by contracting with FINRA as other exchanges do.

As justification for the Proposed Rule, CBOE states that it does not have access to all necessary order and trade information for away-trading activity. CBOE specifically cites that a CBSX Trading Permit Holder may execute a trade as a customer through another broker-dealer on an away market.[15] This issue, however, is not unique to CBOE. Every other national securities exchange has a similar responsibility to enforce all federal securities laws and regulations regardless of trading venue. To satisfy these obligations, other national securities exchanges have not shifted the costs associated with surveillance and monitoring to certain of its member firms by imposing a burdensome new membership requirement that would impact the member firms business on other exchanges.

Instead, other exchanges contracted with FINRA via 17d-2 agreements to obtain the market data necessary or engage in sufficient surveillance to discharge their obligations under the Act and Commission Rules. They also participate in the ISG, as CBOE does. Thus, it is difficult to understand why CBOE feels that it must require FINRA membership in order to discharge its regulatory obligation when no other national securities exchange requires such membership.

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[13] *See* NYSE filing SR-NYSE-2009-63.
[14] *See Id.*, p. 2.
[15] *See* CBOE filing SR-CBOE-2013-100, p.9.

Conclusion

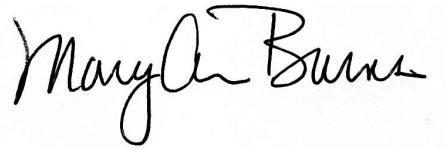
For the reasons listed above, the Proposed Rule should not be approved by the Commission. Alternatively, CBOE should retract and replace the Proposed Rule with a rule that does not violate Section 6(b)(2) Act and is consistent with the rules of other exchanges. Moreover, CBOE should consult with impacted CBSX Trading Permit Holder firms prior to the proposal of such a significant new rule.

The FIA PTG would like to thank the Commission for the opportunity to provide our thoughts on the Proposed Rule. As always, we look forward to playing a constructive role in helping the Commission achieve its regulatory goals in the most effective manner.

Please contact Mary Ann Burns (maburns@futuresindustry.org) if you have any questions regarding this request.

Respectfully,

Futures Industry Association Principal Traders Group



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