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Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **Risk Management Controls for Brokers or Dealers with Market Access;
File No. S7-03-10**

Dear Ms. Murphy:

The Chicago Board Options Exchange, Inc. (“CBOE”) is pleased to share its comments on the proposal by the Securities and Exchange Commission (“SEC” or “Commission”) to adopt new Rule 15c3-5 (“proposal”) under the Securities Exchange Act of 1934.¹ The Rule would require broker-dealers that provide direct or sponsored trading access to an exchange or an alternative trading system (“ATS”) to adopt certain risk management controls and supervisory procedures that are reasonably designed to manage the financial, regulatory, and other risks of the market access.

In general, CBOE believes that the proposal is overly broad in its coverage and would impose unnecessary costs on market participants. We believe that the scope of the proposal needs to be reduced considerably to focus on the risks posed by unfiltered sponsored access. We also believe that the proposed rule does not account for multi-broker access arrangements, where it would be virtually impossible for the broker-dealer providing access to satisfy the proposed rule’s requirements. In addition, we believe the Commission should clarify that outbound routing brokers and exchange facility brokers would not be subject to the proposed requirements. We believe that the proposed rule should not apply to manually-submitted orders and that exchanges continue to be permitted to provide market access services to members. Finally, we believe the Commission should consider the potential adverse impacts the proposal would have on securities exchange-based trading vis-à-vis other trading venues. These thoughts are discussed in more detail below.

The SEC’s Proposal

The proposal would require a broker-dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its market participant identifier (“MPID”) or otherwise, to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks related to market access. The proposal would apply to

¹ Securities Exchange Act Release No. 61379 (Jan. 19, 2010), 75 FR 4007 (Jan. 29, 2010) (“Proposing Release”).

trading in all securities on an exchange or ATS, including equities, options, exchange-traded funds, and debt securities.

Under the proposal, a broker-dealer would be required to have financial risk management controls and supervisory procedures that are reasonably designed to systematically limit the financial exposure of the broker-dealer that could arise as a result of market access. Such financial controls and procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer, or that appear to be erroneous. A broker-dealer also would be required to have regulatory risk management controls and supervisory procedures that are reasonably designed to ensure compliance with all regulatory requirements that are applicable in connection with market access. Such regulatory controls and procedures must be reasonably designed to prevent the entry of orders that fail to comply with any regulatory requirements that must be satisfied on a pre-order entry basis, prevent the entry of orders for securities that the broker-dealer or customer is restricted from trading, restrict market access technology and systems to authorized persons, and assure appropriate surveillance personnel receive immediate post-trade execution reports.

A broker-dealer subject to the proposal would be required to have direct and exclusive control of the required controls and procedures. In addition, a broker-dealer subject to the proposal would be required to regularly review the effectiveness of the required controls and procedures and to promptly address any issues. This regular review must include a review of the broker-dealer's market access business at least annually. Further, the Chief Executive Officer (or equivalent officer) of the broker-dealer would be required to provide an annual certification confirming the broker-dealer's compliance with the requirements. .

Issues Presented by the Proposal

The proposal is intended to address certain risks posed by market access arrangements. It clearly is aimed at the risks arising from high speed trading and the electronic access to marketplaces that some broker-dealers provide customers without any checks or controls being placed on the submission of orders by these customers. CBOE recognizes the risks posed by unfiltered access arrangements, particularly where the customer in essence has direct and unfettered electronic access to a marketplace without being a broker-dealer. As these customers do not have the same regulatory obligations as broker-dealers to maintain internal controls and to comply with exchange and FINRA rules, providing them with unfiltered access could create the risk of market disruptions, financial exposures, and rule violations that would not occur if the orders were handled by a broker-dealer. Consequently, it is not unreasonable for the SEC to propose a rule that would address such unfiltered electronic market access.

We have serious doubts, however, about the need for the proposal to apply to market access arrangements other than unfiltered electronic access. Direct market access arrangements and sponsored access arrangements (other than naked access) do not pose the risks involved with unfiltered electronic access. The SROs have been working with the Commission and the member firm community for several years to reach a reasonable balance on the controls that broker-dealers should have in place for market access arrangements. We understand that broker-dealers in general apply various controls to direct market access and sponsored access arrangements (other than unfiltered access). In addition, SROs have their

own set of rules to address some of the risk issues from market access such as rules relating to clearly erroneous trades, and they also have policies and procedures for other rules such as Regulation NMS (and soon the alternative tick test of Regulation SHO). It seems unnecessary to impose a whole new set of broad pre-trade and post-trade policies and controls on broker-dealers who are not providing unfiltered sponsored access. The far more reasonable approach would be simply to prohibit electronic market access arrangements where pre-trade and post-trade policies and procedures are not imposed by the broker-dealer providing sponsored access. We recommend amending the proposed rule by adopting this simple but effective prohibition.

Another issue raised by the proposal involves situations where multiple broker-dealers are involved in providing access to a marketplace. For example, an introducing broker may provide market access to its customers through its clearing broker, who provides routing mechanisms to various marketplaces. The Clearing Member Trade Assignment (“CMTA”) process is a common multi-broker routing arrangement in the options markets. In multi-broker access arrangements, it would be virtually impossible for the broker-dealer providing access to an exchange or ATS to have all the information necessary to implement the risk procedures and to have direct and exclusive control over the controls. It would also be overly burdensome and duplicative to impose the proposed rule’s requirements to each broker in the chain of access. Given the varied and complex scenarios that exist, the Commission should consult with exchanges and industry representatives before determining how the various requirements of the proposal would apply to multi-dealer access arrangements.

If the Commission determines to impose requirements on broker-dealers providing sponsored or direct market access, we favor the “policies and procedures” approach that the Commission is proposing because it provides flexibility for the SEC and SROs to work with members to formulate and fine-tune procedures with a view toward making them sufficient and consistent across the industry. We also agree with the Commission’s statement that the proposal should allow flexibility for the details of the controls and procedures to vary from broker-dealer to broker-dealer, depending on the nature of the business and customer base, so long as they are reasonably designed to achieve the goals in the proposed rule. Consistent with that objective, we believe there should be more flexibility in applying certain controls on a pre- and/or post-trade basis. Providing this flexibility in the proposed rule would allow for the reasonable and more efficient operation of the proposed rule’s application now and over time.

The Commission should also clarify that the proposal would not apply to outbound routing brokers who access away markets on behalf of exchanges for intermarket linkage purposes. Generally, an outbound routing broker receives instructions from an exchange, routes orders to other exchanges and reports executions back to the exchange. The outbound routing broker cannot change the terms of an order or the routing instructions, nor does the outbound routing broker have any discretion about where to route an order. Moreover, by the time an outbound routing broker receives an order, the order has already passed through an originating broker’s systems and the exchange’s systems. As a result, the function of away market routing on behalf of exchanges does not pose the same risks that the proposal is designed to address. Along the same lines, the proposal should not apply to any broker-dealer that functions as an exchange facility. As an exchange facility, these broker-dealers are subject to specific rules limiting their activity and generally only process orders that have already passed through another broker’s systems.

In the Proposing Release, the Commission states that the proposal will apply to traditional agency brokerage activities. We question the need to apply the proposal to all brokerage activities, and particularly do not believe the proposal is intended to apply to orders handled on a manual basis. As noted above, the driving issue behind the proposal is increased speed and automation of trading on securities exchanges and ATSS, and the provision of market access that allows customers to trade electronically without any controls or checks being applied to orders submitted to marketplaces through such unfiltered access. The concern does not apply at all to orders submitted to a broker manually. Brokers manually receiving an order, whether it be an upstairs sales trader or a broker on the floor of an exchange, can review the order manually to check that the order is not a fat finger or erroneous order, and is not the type of order inconsistent with the customer's normal course of business. We see no need to apply any additional obligations under the proposed rule to brokers receiving orders in this manner. Thus, we recommend that the SEC confirm either that the proposal would not apply to orders manually received or that the proposal would impose no additional obligations to review such orders other than a manual review.

We note that some exchanges provide certain in-bound routing services to broker-dealers sending orders to the particular exchange. Part of these in-bound routing services may include screens to prevent the entry of orders that violate specific checks or exchange rules. For example, an exchange may screen for an order priced far outside the best bid and offer or for an order not marked "close" in a restricted option series. Sometimes these screens enable the routing broker to input certain controls into its order routing process, other times these features are employed by the exchanges on a market-wide basis. These services may be of particular value to broker-dealers desiring to provide electronic market access to their customers. In essence, the exchange is acting as a third party vendor of sponsored access services to the broker-dealer providing market access. The Commission should confirm that, under the proposed rule, exchanges would be able to continue to act as third party vendors of market access and that broker-dealers could utilize such access as long as the other conditions of the proposed rule are being adhered to.

We also have concerns about the adverse competitive impact the proposal would have on exchanges relative to ATS, OTC and futures trading, in particular. For example, unfiltered access by non-broker-dealer customers on an exchange would no longer be permitted, while such activity could continue on an ATS. Exchange trading would be subject to the proposed requirements, while OTC trading would not. Securities under the SEC's jurisdiction would be subject to the proposed rule. However, to our knowledge, the CFTC has not proposed similar requirements for trading in futures products. These inconsistencies in regulation and added costs and burdens would potentially put securities exchanges at a competitive disadvantage vis-à-vis ATSS, OTC markets and futures markets.

Lastly, we believe there are significant issues with respect to operations, compliance and costs that should be resolved before the Commission takes any action to approve the proposed rule. We also note that the Proposing Release did not contain any information on the expected implementation date. We believe that compliance with the proposed requirements would potentially entail significant system efforts by broker-dealers as well as exchanges. If the proposal is ultimately approved, the Commission should provide a reasonable time for any needed changes to be implemented, which should be determined only after consulting with exchanges and industry representatives.

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CBOE appreciates the opportunity to comment on the SEC's proposed rule on risk management controls for market access arrangements. Should you have any questions on the issues discussed in this letter, please contact the undersigned at 312-786-7310.

Sincerely,



Edward J. Joyce
President & Chief Operating Officer

cc. The Hon. Mary Schapiro, Chairman
The Hon. Luis Aguilar, Commissioner
The Hon. Kathleen Casey, Commissioner
The Hon. Troy Paredes, Commissioner
The Hon. Elisse Walter, Commissioner
Mr. Robert W. Cook, Director, Division of Trading and Markets
Mr. James Brigagliano, Deputy Director, Division of Trading and Markets
Ms. Elizabeth King, Associate Director, Division of Trading and Markets
Mr. David S. Shillman, Associate Director, Division of Trading and Markets