September 27, 2022

VIA E-MAIL

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-0609
rule-comments@sec.gov

Re: **Exemption for Certain Exchange Members (File No: S7-05-15)**

Dear Ms. Countryman:

CTC, LLC[1] ("CTC") respectfully submits this letter in response to the U.S. Securities and Exchange Commission's ("SEC" or "Commission") most recent proposal to amend Rule 15b9-1 under the Securities Exchange Act of 1934 ("Exchange Act") to require broker-dealers that engage in off-exchange[2] and off-member-exchange[3] trading to become member of a national securities association ("Proposal").[4] Because the Financial Industry Regulatory Authority ("FINRA") is currently the only approved national securities association, this rule would require all such broker-dealers to join FINRA.

CTC strongly supports well-regulated markets and agrees that regulators should have all the necessary information needed to properly oversee the markets. We also believe that regulation should be efficient to achieve the desirable benefits of healthy and well-functioning markets, while not imposing unnecessary costs on market participants, as those costs may have a detrimental impact on market quality and investors.

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[1] CTC, LLC is a registered broker-dealer that is a proprietary options market maker and a member of the Chicago Board Options Exchange, the C2 Options Exchange, Cboe BZX Options, BOX Options, NYSE Arca Options, NYSE American Options, Nasdaq ISE, and Nasdaq Phlx.

[2] The Proposal indicates that "off-exchange" means any securities transaction that is covered by Section 15(b)(8) of the Exchange Act that is not effected, directly or indirectly, on a national securities exchange. *See* 17CFR 240.600(b)(45) (defining "national securities exchange"). Off-exchange trading includes securities transactions that occur through alternative trading systems ("ATSs") or with another broker or dealer that is not a registered ATS and is also referred to as over-the-counter ("OTC") trading.

[3] The Proposal characterizes "off-member-exchange" trading as when broker-dealer firms that are not FINRA members effect securities transactions otherwise than on an exchange of which they are a member.

[4] Exchange Act Release No. 95388 (July 29, 2022), 87 FR 49930 (Aug 12, 2022)

As we have stated in prior comment letters,[5] we believe that the Commission has not fully considered the disproportionate impact that this Proposal will have on the options markets and investors in those markets. Furthermore, we believe that the current Proposal is not well-tailored to the problems it is trying to solve, it is not necessary or appropriate in the public interest, and it does not promote regulatory efficiency.[6] For these reasons, which are further explained below, CTC believes that the current Proposal should not be adopted and, if it is ultimately adopted in a revised form, Rule 15b9-1 should include an exemption for activity that is conducted to hedge market making positions.

I. The Proposal is not well-tailored to the problems it is trying to solve because it treats *direct* off-exchange and off-member-exchange trading by non-FINRA member broker-dealers the same as activity conducted through a FINRA member broker-dealer.

In the Proposal, the Commission describes a need to realign Rule 15b9-1 with the current market so that the regulatory scheme more appropriately effectuates Exchange Act principles regarding complementary exchange SRO and Association oversight.[7] Specifically, the Proposal describes the framework set forth in the Exchange Act for broker-dealer regulation that, in addition to Commission oversight, requires a layer of SRO oversight, pursuant to which SROs act as front-line regulators of their broker-dealer members.[8] The Proposal further describes that SRO oversight of an exchange's members and their trading on the exchange is primarily the responsibility of the exchange, whereas SRO oversight of other trading activity, such as off-exchange trading, is primarily the responsibility of an Association.[9]

In support of this rulemaking, the Proposal identifies two primary areas where the current Rule 15b9-1 is not consistent with these fundamental principles: 1) broker-dealers that are a member of one or more SROs but not members of FINRA conducting significant trading off-exchange or off-member-exchange; and, 2) certain Treasury security transactions that are not required to be reported to FINRA's Trade Reporting and Compliance Engine ("TRACE"), a reporting system for fixed income securities, because the broker-dealer firms executing them are not FINRA members.

With respect to the first problem, broker-dealers that are a member of one or more SROs but not members of FINRA conducting significant trading activity off-exchange or off-member-exchanges, the Proposal conflates two very different types of activity and suggests that the simple solution is to require all firms that conduct off-exchange or off-member-exchange activity to join an Association (FINRA). This may indeed be a simple solution, but it imposes the significant expense and other burdens of FINRA

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[5] Frank A. Bednarz, CTC Trading Group, L.L.C., Letter Dated June 1, 2015 ("2015 CTC Letter") and Eric Chern et al, CTC, LLC, Akuna Capital LLC, Belvedere Trading LLC, Consolidated Trading LLC, Cutler Group LP, Group One Trading, LP, Integral Derivatives, LLC, The Options Clearing Corporation, Optiver US, LLC Peak 6 Capital Management, LLC, Volant Trading, Letter Dated July 13, 2016 ("2016 Multi-firm Letter").

[6] Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking pursuant to the Exchange Act, to consider or determine whether an action is necessary or appropriate in the public interest, and to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. *See* 15 U.S.C.78c(f).

[7] Proposal, p. 10

[8] Proposal, p. 11

[9] Proposal, p. 12

membership on firms that are not part of the problem and are already regulated consistent with the principles described in the Proposal.

CTC agrees with the Commission that certain proprietary trading firms benefit from the exemption in Rule 15b9-1 in a manner that was not envisioned at the time it was adopted and later amended. Indeed, broker-dealers that are members of one or more exchange SROs, but not FINRA, and conduct most of their trading *directly* on alternative trading systems ("ATSs") or exchanges of which they are not a member, appear to be circumventing the regulatory framework described in the Proposal.[10]

This, however, is a very different situation than firms that are members of numerous exchange SROs, actively trading on their member exchanges every day, and do not need to be FINRA members because, when they conduct off-exchange or off-member exchange activity, they do so through a FINRA member broker-dealer. CTC respectfully submits that this activity is already regulated in accordance with the Exchange Act, it is overseen by the SEC and either an exchange SRO, for member exchange activity, or by FINRA, for the activity conducted through a FINRA member broker-dealer. Requiring these firms to also join FINRA themselves, effectively imposing triple regulation, is unnecessary, is not consistent with the Exchange Act, and is not well-tailored to solving the problem described in the Proposal.

With respect to the second problem cited in the Proposal, that certain Treasury security transactions are not reported to TRACE because non-FINRA member broker-dealer firms are not required to report them, CTC agrees that this problem significantly reduces transparency in the Treasury markets. However, CTC respectfully submits that this gap in regulatory reporting can be rectified by a simpler approach, such as the one suggested by Commissioners Peirce and Uyeda, that conditions the exemption in Rule 15b9-1 on non-member firms reporting these transactions to TRACE.[11] Such a solution would be much better tailored to the problem it is trying to solve without imposing the many burdens of FINRA membership.

II. The Proposal is not necessary or appropriate in the public interest[12] because activity executed on a member exchange or through a FINRA member broker-dealer is already consistent with the Exchange Act.

In the Proposal, the Commission asserts that the rulemaking is necessary to appropriately effectuate the Exchange Act framework for broker-dealer regulation that, in addition to Commission oversight, requires a layer of SRO oversight.[13] The Proposal also describes a related overarching principle within the Exchange Act, that the SRO best positioned to conduct regulatory oversight should assume that responsibility, with exchange SROs regulating activity of their members and their trading activity on the exchange, and SRO

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[10] "Accordingly, a registered dealer can rely on Rule 15b9-1 to remain exempt from Association membership while engaging in unlimited proprietary trading of securities on any national securities exchange of which it is not a member or in the off-exchange market, so long as it is a member of a national securities exchange, carries no customer accounts, and its proprietary trading is conducted with or through another registered broker-dealer." Proposal, p. 5

[11] Statement of Commissioners Hester M. Peirce and Mark T. Uyeda on Proposed Amendments to Exchange Act Rule 15b9-1 (July 29, 2022)

[12] *Id.* at 4

[13] *Id.* at 6

oversight of other trading activity, such as off-exchange trading, primarily being the responsibility of an Association.[14]

CTC submits that the regulatory scheme of complementary exchange SRO and Association oversight is exactly what is already happening for all activity conducted on member exchanges or through a FINRA registered broker-dealer. The trading activity engaged in on member exchanges is already conducted pursuant to Commission oversight, as well as the oversight of an exchange SRO of which it is a member, consistent with regulatory framework outlined in the Exchange Act. Additionally, any off-exchange or off-member-exchange trading that is conducted through a FINRA member broker-dealer is also conducted pursuant to Commission oversight as well as an Association (FINRA), consistent with regulatory framework outlined in the Exchange Act. In other words, in addition to SEC oversight, trading activity on member exchanges is being regulated by an exchange SRO, and off-exchange and off-member-exchange trading activity through a FINRA registered broker dealer is being regulated by an Association (FINRA), which is exactly what is contemplated by the Exchange Act.

Additionally, because all such trading activity is required to be reported to the Consolidated Audit Trail ("CAT"), there are no gaps in reporting regulatory data to FINRA. As such, CTC respectfully submits that, to the extent that the current Proposal requires firms that execute trades either on member exchanges or through a FINRA member broker-dealer to themselves join FINRA, it is not necessary or appropriate in the public interest.

III. The Proposal does not promote regulatory efficiency[15] because the costs of FINRA membership are disproportionate to any benefit obtained.

CTC believes that the current Proposal does not promote regulatory efficiency because the costs of FINRA membership are significant and disproportionate to any benefit obtained. CTC estimates the one-time costs to join FINRA, and the ongoing annual compliance costs for FINRA membership, to each be millions of dollars. In addition to these costs, CTC would be subject to the Trading Activity Fee ("TAF") and Section 3 fees as described in the Proposal, which are harder to estimate, but would be significant based upon CTC's trading activity.

Like many in the industry, CTC has already spent a significant amount time and money complying with CAT reporting requirements and, as a result, CTC does not believe there are currently any regulatory data reporting gaps. Furthermore, the Proposal notes that for firms such as options market makers, the amount of off-exchange and off-member-exchange activity is generally relatively small. In fact, the Commission estimates that options order executions initiated by firms on exchanges of which they are not a member represented just approximately 3% of these firms' total options contract volume reported in 2021, and just 1% of all reported options contract transaction volume.[16] To force such firms to assume the significant burdens of FINRA membership for a relatively small amount of overall trading activity, especially if this activity is already being conducted through a FINRA member broker-dealer, is

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[14] *Id.* at 7

[15] *Id.* at 4

[16] Proposal, p. 27 note 81

unnecessary from a regulatory standpoint and does not promote regulatory efficiency as required by the Act.

IV. Any revised Proposal should exempt any off-exchange and off-member-exchange trading to hedge market maker positions.

As described in the Proposal, Section 15(b)(8) of the Act[17] prohibits any registered broker or dealer from effecting transactions in securities unless it is a member of an Association or effects transactions in securities solely on an exchange of which it is a member.[18] Section 15(b)(9) of the Act[19] provides the Commission with the authority to exempt any broker or dealer from Section 15(b)(8), if that exemption is consistent with the public interest and the protection of investors.

Both Commission and SRO rules recognize a specific classification for firms engaged in options market making that is separate and distinct from the general classification of proprietary traders.[20] This specific SRO classification designates options market maker quoting obligations, among other obligations, that do not apply to all proprietary traders. While meeting these market making obligations, options market making firms must maintain a diverse options portfolio that they must be able to manage and hedge. For example, in order to offset the risks associated with carrying diverse options positions, options market makers must be able to hedge their portfolio with the related underlying equity products. In addition, as most options products are listed in multiple venues, options market makers must be able to view and access each options exchange in order to evaluate risk as well as comply with regulatory obligations. This hedging activity is a critical market function that removes risk from the markets and allows options market makers to provide tighter and deeper markets for all market participants. Therefore, CTC proposes that any revised Proposal include a "Hedging Activity Exemption" for off-exchange and off-member exchange trading activity that is conducted for the purpose of hedging market making positions. Such an exemption would allow this critical market function to continue without imposing an undue burden on options market making firms and would be consistent with the public interest and the protection of investors.

In summary, CTC believes that the current Proposal is not well-tailored to the problems it is trying to solve, it is not necessary or appropriate in the public interest, and it does not promote regulatory efficiency, primarily because it does not recognize the distinction between off-exchange and off-member-exchange conducted *directly* versus that activity conducted through a FINRA member broker-dealer, which is already regulated in accordance with the Exchange Act. Furthermore, any revised proposal should formally recognize a Hedging Activity Exemption for non-FINRA member broker-dealers that do not have customers and conduct off-exchange or off-member-exchange trading to hedge market maker positions,

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[17] 15 U.S.C. 78o(b)(8).

[18] Section 15(b)(8) applies to any security other than commercial paper, bankers' acceptances, or commercial bills. *Id.*

[19] 15 U.S.C. 78o(b)(9).

[20] There are a variety of Commission net capital rules that apply to option market makers. Specifically, these rules apply to a dealer who does not effect transactions with anyone other than brokers or dealers, who does not carry customers' accounts, who does not effect transactions in unlisted options, and whose market maker or specialist transactions are effected through and carried in a market maker or specialist account cleared by another broker or dealer. See 17 CFR 240.15c3-1(a)(6), 240.15c3-1(b)(1), and 240.15c3-1(c)(2)(vi)(N). In addition, each SRO has rule books that address the appointment and quoting obligations of options market makers.

at a minimum when this activity is conducted through a FINRA-member broker-dealer, and, we suggest, also if these trades are conducted *directly*.

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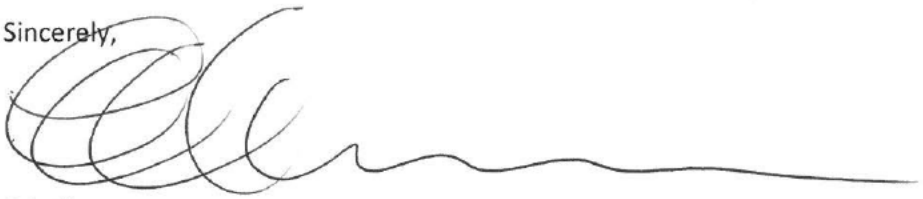
Should you have any questions with respect to this letter, please contact our General Counsel, James Ongena at [redacted] or [redacted], we would welcome the opportunity to discuss it further and appreciate the opportunity to respond.

Sincerely,



Eric Chern
Co-Founder

cc: The Honorable Gary Gensler, Chair
Commissioner Hester M. Peirce
Commissioner Caroline A. Crenshaw
Commissioner Mark T. Uyeda
Commissioner Jaime Lizárraga
Haoxiang Zhu, Director, Division of Trading and Markets
David S. Shillman, Division of Trading and Markets