

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70806; File No. SR-CBOE-2013-100)

November 5, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to CBSX Trading Permit Holder Eligibility

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 23, 2013, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt a CBOE Stock Exchange, LLC (“CBSX”) rule regarding eligibility for CBSX Trading Permit Holders. The text of the proposed rule change to [sic] is also available on the Exchange’s website

(<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

CBSX is a stock execution facility of CBOE. Therefore, CBOE, as a self-regulatory organization, conducts surveillance of trading on CBSX, and surveils and examines the securities-related operations of its Trading Permit Holders for compliance with CBSX Rules and the federal securities laws, rules and regulations. The Exchange proposes to add CBSX Rule 50.4A.<sup>3</sup> Proposed CBSX Rule 50.4A provides that a CBSX Trading Permit Holder may become or remain a CBSX Trading Permit Holder only if it is a member of a national securities association.<sup>4</sup> All CBSX Trading Permit Holders that are effective as of the approval date of this filing shall have six months from the date of approval of this rule filing to become a member of a national securities association. The proposed rule also provides that CBSX will terminate, upon

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<sup>3</sup> The proposed Rule also furthers compliance with Undertaking O of the June 11, 2013 Order Instituting Administrative and a Cease-and-Desist Proceedings (“Order”) involving CBOE and its affiliate exchange, C2 Options Exchange, Incorporated (“C2”). Undertaking O requires CBOE to enhance its regulation of 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 a national securities association (“CBSX-Only Trading Permit Holders”). The proposed rule change is only one component of the Exchange’s effort to enhance its regulation of all CBSX Trading Permit Holders, including CBSX-Only Trading Permit Holders, and to satisfy Undertaking O. Although there will technically no longer be any CBSX-Only Trading Permit Holders if the proposed rule change is approved, the Exchange still believes the proposed rule change will enhance the general regulatory oversight of CBSX Trading Permit Holders, including those former CBSX-Only Trading Permit Holders, as further described in this filing.

<sup>4</sup> Currently, Financial Industry Regulatory Authority, Inc. (“FINRA”) is the only registered national securities association.

written notice, the Trading Permit Holder status of any CBSX Trading Permit Holder that fails to meet this requirement.<sup>5</sup>

CBSX Trading Permit Holders may submit orders to other trading venues as customers through executing broker-dealers, which are ultimately executed on those other trading venues (“away-trading activity”). Because away-trading activity does not occur on CBSX’s market, CBOE does not have access to all necessary order and trade information for this trading activity, as it does for trading activity done directly on CBSX, from which it can directly conduct systematic surveillance reviews.<sup>6</sup> As such, the Exchange believes that the proposed CBSX Trading Permit Holder eligibility requirement will enhance the general regulatory oversight of CBSX Trading Permit Holders and their away trading activity.

More specifically, FINRA rules currently require each FINRA member to submit order data for its trading activity on all trading venues (including its away-trading activity) to FINRA on a regular basis.<sup>7</sup> Through this audit trail, FINRA has the necessary information related to each member’s away-trading activity to review for and detect possible violations of the federal securities laws, rules and regulations, including those related to anti-fraud and anti-manipulation. The proposed requirement that all CBSX Trading Permit Holders be members of a national

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<sup>5</sup> The Exchange notes that the termination of the Trading Permit Holder status of a CBSX Trading Permit Holder, that is also a CBOE Trading Permit Holder, in accordance with proposed Rule 50.4A, will not affect that CBSX Trading Permit Holder’s status as a CBOE Trading Permit Holder.

<sup>6</sup> The Exchange notes that as a member of the Intermarket Surveillance Group (“ISG”), the Exchange receives an equity audit trail of all equity market orders and trade information for away-trading activity. However, the equity audit trail the Exchange receives does not provide the granular level of detail to denote when a CBSX Trading Permit Holder is executing a trade as a customer through another broker dealer on an away market. Without such granular information, the Exchange is limited in the reviews it can conduct of this away activity.

<sup>7</sup> See, e.g., FINRA Rules 7440 and 7450.

securities association (i.e., FINRA) to remain or become a CBSX Trading Permit Holder ensures that CBSX Trading Permit Holders are submitting their order data for their trading activity on all trading venues (including away-trading) on a regular basis to FINRA, thus allowing FINRA to detect possible violations of federal securities laws, rules, and regulations, including those related to anti-fraud and anti-manipulation. Moreover, if FINRA detects potential violative activity, it has the authority to take appropriate regulatory and disciplinary action against the CBSX Trading Permit Holder as one of its regulators, or otherwise refer such matter to CBOE for further review and consideration of disciplinary action. The Exchange notes that certain other exchanges require their members to be members of another national securities exchange or a national securities association.<sup>8</sup> The Exchange believes that requiring CBSX Trading Permit Holders to be a member of FINRA but not providing the option of becoming a member of another national securities exchange is appropriate to ensure that the CBSX Trading Permit Holders' away-trading activity is subject to appropriate regulatory review. As is the case with CBSX, other national securities exchanges may not have direct access to the order and transaction information related to the away-trading activity of its members and therefore would not be in a position to review the activity for potential violations of federal securities laws, rules and regulations.<sup>9</sup> Additionally, the Exchange notes that requiring CBSX Trading Permit Holders to be a member of FINRA is similar to former NYSE Rule 2(b), which provided that

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<sup>8</sup> See, e.g., BATS Exchange, Inc. Rule 2.3, BATS Y-Exchange, Inc. Rule 2.3, EDGA Exchange, Inc. Rule 2.3(a), EDGX Exchange, Inc. Rule 2.3(a), NASDAQ Stock Market LLC Rule 1002(e), and New York Stock Exchange LLC Rule 2.

<sup>9</sup> The Exchange notes that it will be in a position to have an audit trail of this “away activity” from which it will be able to conduct direct systematic surveillance reviews once the National Market System consolidated audit trail (“CAT”) is finalized and implemented.

membership in FINRA was a condition precedent to becoming a member organization of NYSE.<sup>10</sup>

Finally, proposed Rule 50.4A provides that the Trading Permit Holder Status of a current CBSX Trading Permit Holder will be terminated upon written notice if it fails to meet the eligibility requirement set forth in the proposed rule (i.e., to become a member of a national securities association). The Exchange recognizes that certain CBSX Trading Permit Holders may need a reasonable amount of time to become members [sic] FINRA. Accordingly, the Exchange proposes to require CBSX Trading Permit Holders to become a member of FINRA within six months of the date of approval of this rule change.<sup>11</sup> The Exchange will announce the date by which CBSX Trading Permit Holders must comply with this new requirement (the “Compliance Date”) in a Regulatory Circular to be published no later than seven (7) days following the approval of this filing.<sup>12</sup> Notwithstanding the foregoing, if the Exchange determines that there are extenuating circumstances which result in a CBSX Trading Permit Holder not being able to comply by the Compliance Date, the Exchange may permit a CBSX Trading Permit Holder to retain its Trading Permit Holder status beyond the Compliance Date for such period of time as the Exchange deems reasonably necessary to enable the CBSX

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<sup>10</sup> See Securities Exchange Act Release No. 56654 (October 12, 2007) 72 FR 59129 (October 18, 2007) (Order Approving Proposed Rule Change Relating to NYSE Rule 2) (SR-NYSE-2007-67). NYSE subsequently amended Rule 2(b) in 2009 to make its rule similar to BATS Rule 2.3, in order “to make its membership more broadly available to other registered brokers or dealers who are not FINRA members but who are members of another registered securities exchange and do not transact business with public customers or conduct business on the Floor of the [NYSE].” See Securities Exchange Act Release No. 60318 (July 16, 2009) 74 FR 36797 (July 24, 2009) (SR-NYSE-2009-63).

<sup>11</sup> Currently, there are 42 CBSX Trading Permit Holders that would be affected by this eligibility requirement (i.e., are not already members of FINRA).

<sup>12</sup> The Exchange will also issue periodic written reminders to all CBSX Trading Permit Holders affected by this requirement that the CBSX Trading Permit Holder must become a FINRA member by the Compliance Date.

Trading Permit Holder to become a member of FINRA.<sup>13</sup> In the event the firm fails to meet this eligibility requirement by the Compliance Date, the Exchange will issue written notice to the CBSX Trading Permit [sic] that its Trading Permit Holder status will terminate in thirty (30) days in accordance with proposed Rule 50.4A and Rule 3.5, unless the CBSX Trading Permit Holder was granted an extension based upon extenuating circumstances or the CBSX Trading Permit Holder files a timely appeal in accordance with the provisions of Chapter XIX. The Exchange notes there is similar authority to terminate a CBSX Trading Permit Holder under Rules 3.5 and 3.19 with respect to current eligibility requirements of CBSX Trading Permit Holders. The Exchange believes this proposed provision (which would require termination upon failure to satisfy the proposed eligibility requirement) is appropriate to ensure that all trading activity of CBSX Trading Permit Holders will be subject to appropriate oversight and regulation.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>14</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>15</sup> requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national

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<sup>13</sup> The Exchange notes that the ability to extend certain time limits where extenuating circumstances exist is consistent with and similar to other Exchange rules. See e.g., CBOE Rule 3.19 and CBOE Rule 3.30.

<sup>14</sup> 15 U.S.C. 78f(b).

<sup>15</sup> 15 U.S.C. 78f(b)(5).

market system, and, in general, to protect investors and the public interest. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>16</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes that the proposed rule change will improve its oversight of all CBSX Trading Permit Holders by enhancing the ability to detect, regardless of trade venue, potential violations of CBSX rules and federal securities laws, rules and regulations, including anti-fraud and anti-market manipulation rules, which will help to prevent fraudulent and manipulative acts and practices and promote just and equitable principles of trade.

Additionally, the proposed rule change will enhance CBOE's regulation of CBSX-Only Trading Permit Holders in particular as required by Undertaking O of the Order, which is consistent with the Section 6(b)(5) requirements. More specifically, as described above, all CBSX Trading Permit Holders, including CBSX-Only Trading Permit Holders, would be required to submit their order data for their trading activity on all trading venues (including away-trading) on a regular basis to FINRA, thus allowing FINRA to detect possible violations of federal securities laws, rules, and regulations, including those related to anti-fraud and anti-manipulation. If FINRA detects potential violative activity, it may refer such matter to CBOE for further review and consideration of disciplinary action.

The Exchange also believes that the proposed rule change is designed to not permit unfair discrimination among market participants as the proposed rule change will apply to all CBSX Trading Permit Holders. While the proposed rule change may impose an additional burden on CBSX Trading Permit Holders, the Exchange believes this is outweighed by the Exchange's

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<sup>16</sup> Id.

need to enhance its regulation of the CBSX market and the overall trading activity of CBSX Trading Permit Holders, which enhanced regulation will ultimately protect investors and the public interest. The Exchange believes that any additional burden imposed on CBSX Trading Permit Holders that would not currently satisfy the proposed eligibility requirement is justified because their away-trading activity may currently be subject to less regulation than that of the CBSX Trading Permit Holders that would currently satisfy the proposed eligibility requirement. The proposed rule change will ultimately subject the trading activity of all CBSX Trading Permit Holders to a similar level of regulatory oversight.

B. Self-Regulatory Organization's Statement on Burden on Competition

CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe that the proposed rule change will impose an unnecessary burden on intramarket competition because it would apply equally to all CBSX Trading Permit Holders. Additionally, the proposed rule change is not designed to address any competitive issues. Rather, the proposed rule change is intended to enhance its regulation of all CBSX Trading Permit Holders, including CBSX-Only Trading Permit Holders, and is one part of the Exchange's overall effort to comply with Undertaking O of the Order. The Exchange believes the proposed rule change will enhance the oversight of CBSX Trading Permit Holders' overall trading activity and the ability of the Exchange and other self-regulatory organizations to detect violations of federal securities laws, rules and regulations, including anti-fraud rules. While the proposed rule change may impose an additional burden on CBSX Trading Permit Holders, the Exchange believes this burden is similar to a burden imposed by several other exchanges on their



members<sup>17</sup> and is outweighed by the Exchange's need to enhance its regulation of the CBSX market and the trading activity of CBSX-Only Trading Permit Holders, which enhanced regulation will ultimately benefit all market participants. See the discussion above for additional information regarding the potential burden imposed by the proposed rule change on CBSX Trading Permit Holders.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- A. by order approve or disapprove such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be

disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

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<sup>17</sup> See supra note 6 [sic].

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2013-100 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2013-100. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer

to File Number SR-CBOE-2013-100 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).