



June 1, 2015

VIA E-mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Mr. Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-0609

RE: Exchange Act Release No. 34-74581; File No. S7-05-15  
Exemption for Certain Exchange Members

Dear Mr. Fields:

CTC, L.L.C. ("CTC") respectfully submits this letter in response to the U.S. Securities and Exchange Commission's ("SEC" or Commission") proposal to amend Rule 15b9-1 under the Securities Exchange Act of 1934 ("Exchange Act") to require broker-dealers that engage in off-exchange trading to become members of a national securities association ("Proposal").<sup>1</sup>

CTC was established in January 1998. CTC's business focus has been trading in the capacity of an options market maker. CTC is currently a registered broker-dealer and a member firm at the Chicago Board Options Exchange, C2 Options Exchange, NYSE ARCA Options Exchange, NYSE Amex Options Exchange, International Securities Exchange and NASDAQ OMX PHLX Exchange. As a broker-dealer and options exchange member, CTC is subject to direct regulatory oversight by the options exchanges, FINRA (as an agent of the options exchanges), and the Commission. Certain rules of The Options Clearing Corporation also are applicable to CTC's options trading activities.

CTC appreciates the opportunity to comment on the Proposal and, in particular, on the way in which CTC believes such Proposal should be properly tailored to the specific business of proprietary options market making firms. Options market makers have an affirmative obligation to provide continuous two-sided markets, thus ensuring both depth and liquidity for each product in the marketplace. While meeting its market making obligations, CTC, like most options market makers, maintains a diverse options portfolio and must be able to hedge its portfolio with the related underlying equity products. As explained in detail below, there are a number of elements in the Proposal that would negatively impact options market makers such as CTC. This negative impact to options market makers seems to be an unintended consequence of this Proposal and of the Commission's desire to secure

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<sup>1</sup> Exchange Act Release No. 74581 (Mar. 25, 2015), 80 FR 18035 (Apr. 2, 2015).

FINRA jurisdiction for market participants that are not currently regulated by FINRA and which may not be members of securities/options exchanges.

***I. There is No Regulatory Need for CTC to Become a FINRA Member***

One of the primary tenets of the Proposal appears to be the Commission's desire to obtain cross-market surveillance for active proprietary trading firms that may not currently be subject to SRO oversight with respect to a significant amount of their trading activity. It further appears, based upon the drafting of the Economic Analysis portion of the Proposal, that a primary focus for this Proposal was the 14 non-FINRA member firms that connected to Alternative Trading Systems ("ATS") directly without the intermediation of another broker-dealer during the fourth quarter of 2014.<sup>2</sup> These 14 non-FINRA member firms, unlike CTC, conduct a large amount of their trading activity directly with the ATSs that are subject to the jurisdiction and oversight of FINRA but are not currently subject to direct regulatory oversight by FINRA. Thus, by requiring these 14 non-FINRA member firms (and firms similarly situated to the 14 non-member firms) to register as FINRA members, the SEC will indeed obtain a cross-market review that it currently does not capture.

In our view, however, requiring options market making firms such as CTC to register with FINRA would not improve cross-market surveillance in a meaningful way. CTC does not maintain a direct connection to any ATS, and CTC's membership in six options exchanges that have outsourced their regulatory function to FINRA means that FINRA personnel, as agents of the exchanges of which CTC is a member, already regulate CTC.<sup>3</sup> In other words, FINRA already has cross-market surveillance capabilities for the markets in which CTC is most active as an options market maker. Any value of FINRA membership to options market makers is negligible at best.

In addition, notwithstanding the assertion in the Proposal that "[e]xchanges generally do not have a detailed set of member conduct rules,"<sup>4</sup> we submit that the options exchanges' rule sets are far more tailored and meaningful to the conduct of proprietary options market making firms such as CTC than those of FINRA. These options exchange rule sets are the result of years of development involving member firms and the options exchanges and are approved by the Commission. These options exchanges, together with their membership, have focused on developing rule sets tailored not only to options trading, but more specifically to proprietary options market makers. In contrast, FINRA has historically developed a deeper

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<sup>2</sup> See Proposal at 65 and footnote 153. It remains unclear to us the kind of firms that are – and are not – captured within the group of 14 Large Firms.

<sup>3</sup> We understand that FINRA maintains long-standing regulatory services agreements ("RSAs") with every options exchange that provides FINRA with detailed data related to all transactions in the options markets irrespective of whether the firms engaged in such transactions are non-FINRA members.

<sup>4</sup> Proposal at 25.

expertise in the regulation of firms with customer business. Thus, it is misleading to suggest that these options exchange rules sets are somehow inadequate or less stringent than those of FINRA.

## **II. FINRA's Proposed OATS Enhancements Adequately Address Any Current Gaps in Data Reporting**

In addition to trading on the options exchanges, firms like CTC may also trade on securities exchanges and on ATSs. At CTC, this activity is done solely to hedge the diverse options portfolio positions taken by the firm as a result of trading on an options exchange with which the firm is registered. To the extent that CTC engages in on-exchange hedging activity on a securities exchange of which it is not a member, or off-exchange hedging activity on an ATS, CTC transacts exclusively through a FINRA member firm. Accordingly, CTC's trading activity is consistently reported to FINRA's Order Audit Trail System ("OATS") by the FINRA member firm through which CTC transacts.

The Proposal notes concern that certain transactions that are reported to OATS by FINRA member firms on behalf of non-FINRA member firms may not identify the non-FINRA member firm by name.<sup>5</sup> Importantly, however, the Proposal also cites the recently proposed amendments by FINRA that would address this perceived "gap" in reporting of non-FINRA member firm names by requiring additional information to be reported to OATS.<sup>6</sup> Under the proposed FINRA amendments, FINRA member firms that report an order received from a non-FINRA member firm would be *required* to identify the non-FINRA member firm as part of their OATS reporting obligations.<sup>7</sup> These amendments appear to get at precisely the concern raised in the Proposal regarding gaps in data reporting. Indeed, the FINRA Regulatory Notice announcing the proposed amendments states, "FINRA believes that this proposal will significantly improve its ability to support cross-market surveillance and monitor OTC trading by specifically identifying broker-dealers responsible for order activity."

In addition to changes to OATS reporting of non-FINRA member firm activity through FINRA member firms, FINRA has also proposed changes to ATS disclosure requirements that, if adopted, would increase the level of transparency FINRA has into these markets.<sup>8</sup> CTC believes that imposing more robust standards and obligations on ATS firms is a more efficient and direct way to manage the surveillance of off-exchange trading activity.

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<sup>5</sup> See Proposal at 72-73.

<sup>6</sup> See Proposal, *supra* note 1, at 72, n.173, *citing* FINRA Regulatory Notice 14-51, Equity Trading Initiatives: OATS and ATS Reporting Requirements (Nov. 14, 2014).

<sup>7</sup> See FINRA Regulatory Notice 14-51, Equity Trading Initiatives: OATS and ATS Reporting Requirements (Nov. 14, 2014) at 3.

<sup>8</sup> *Id.* at 4.

We urge the Commission to consider the changes that are already underway at FINRA with respect to OATS reporting and ATS disclosure as an alternative to FINRA registration and as an appropriate means of addressing the issues the Proposal raises with respect to cross-market surveillance and identifying activity of non-FINRA member firms. We further ask the Commission to consider an extension of time to comment on this Proposal until more clarity can be obtained regarding the OATS reporting and ATS disclosure changes that are currently under consideration, as these changes may impact the implementation and timing of the current Proposal.

### ***III. Costs of FINRA Membership for Options Market Makers Like CTC Are Disproportionate to Any Benefit Obtained***

CTC is a supporter of regulated markets and concurs strongly that regulators should have information readily available to them in order to perform their necessary functions. CTC also believes that regulation should be efficient so as to achieve the desirable benefits of healthy and well-functioning markets while not imposing compliance costs on market participants that could otherwise be avoided.

Given the various costs associated with FINRA membership explained below, coupled with the impending implementation of entirely new reporting requirements under the Consolidated Audit Trail (“CAT”) by the SEC, CTC believes the costs of becoming FINRA members far outweigh any regulatory benefit.

#### **A. OATS Compliance**

We understand that there are a number of market participants who would be subject to FINRA membership if the Proposal were adopted that are not currently required to report to OATS. CTC is such a firm and currently relies on the FINRA member firms through which it transacts on exchanges and ATSS with which CTC is not registered to complete the required OATS reporting.

In this particular case, not only do we see the potential for duplicative data being reported through OATS, we also see duplicative efforts generated at both the SEC and FINRA level. If adopted, such a seemingly disjointed approach will result in new direct costs to implement OATS reporting, which we estimate to be approximately \$3 million for CTC. Once coming into OATS compliance, CTC would then need to come into compliance with the CAT, which we understand will be designed in such a way to obviate the need for OATS.<sup>9</sup>

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<sup>9</sup> The Proposal acknowledges that the costs of CAT may ultimately “supplant” the costs of OATS but does not fully address the costs of this duplicative implementation for firms that are not current FINRA members. *See Proposal at footnote 219.*

The OATS to CAT transition would mean that the OATS reporting system CTC would be required to put in place as a new FINRA member – which, again, would only be to report identical trades already being reported by the FINRA member firm CTC currently transacts through on the securities exchanges of which it is not a member or on an ATS – would be obsolete in a short number of months or years and would require CTC to build an entirely new reporting system to comply with CAT requirements once in effect. The Proposal acknowledges these costs to some extent, but appears to relate them to the group of “14 Large Firms” and suggests that the cost would not be meaningful to other market participants who are not in that group.<sup>10</sup> The introduction of millions of dollars of regulatory compliance expense is meaningful to CTC.

#### B. Trading Activity Fees

In addition to the significant costs of coming into OATS compliance, the FINRA Trading Activity Fee (“TAF”) would be a considerable sum for CTC to incur as a FINRA Member. FINRA’s TAF is a regulatory fee based on trading activity and applies to all sales of a covered security regardless of where the trading occurs and whether it is on a proprietary or agency basis. CTC estimates that the TAF for the firm in the first several years of FINRA membership would be significant.

Earlier this month, FINRA released a Regulatory Notice to request comment on proposed exemptions for TAF for proprietary trading firms (“TAF Reg Notice”).<sup>11</sup> CTC supports FINRA’s proposed TAF structure contained in the TAF Reg Notice. The comment period for the TAF Reg Notice closes on June 19, 2015. Given the changing landscape of the FINRA TAF structure, it is impossible for CTC to estimate the impact of this potentially significant cost. We echo the request for additional time submitted by FIA’s Principal Trader’s Group on May 6, 2015, which references the TAF Reg Notice and asks the SEC to extend the comment period on the Proposal to afford market participants additional time to respond.<sup>12</sup>

#### C. Additional Costs, Annual Audits and Examinations

CTC estimates that the initial total cost of implementation to become a FINRA member, which include implementation of OATS reporting, to be approximately \$3.5 million. CTC also estimates that the ongoing compliance costs for FINRA membership to be approximately \$1.5 million, annually. These costs are significant, particularly in light of the fact that CTC is already regulated by the options exchanges that have outsourced their regulatory function to FINRA and that FINRA is already able to access all of CTC’s trade data via OATS and the exchanges directly.

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<sup>10</sup> See Proposal at 94-96.

<sup>11</sup> See FINRA Regulatory Notice 15-13, Trading Activity Fee (TAF), (INSERT EXACT DATE).

<sup>12</sup> See <http://www.sec.gov/comments/s7-05-15/s70515-6.pdf>.

Assuming that the SEC adopts the changes in the Proposal and requires FINRA membership for all broker-dealers, CTC is concerned that FINRA membership fees will only rise with no competitive forces to restrain the increase of such fees. We believe the Proposal unduly imposes costs on non-FINRA member firms like CTC with limited increased regulatory benefit. Ultimately, these regulatory costs will further reduce liquidity and force more market participants out of the marketplace.

These ongoing FINRA membership costs will also be layered on top of the costs of membership in the options exchanges of which CTC will continue to be a member. As a result, FINRA will get paid twice for its regulatory oversight, once, directly from the FINRA membership and again, from the SROs who have outsourced their regulatory function to FINRA.<sup>13</sup> For firms like CTC, the cost of membership in the options exchanges reflects a strong value – both to the exchanges and to CTC – when balanced against the regulatory benefits obtained by the options exchanges and market participants who are members of those options exchanges. This would not be the case if firms like CTC were subject to the rules of FINRA membership where the value – if any – inures only to the regulator.

#### ***IV. Alternative Approaches***

If the Commission decides to move forward with adopting the amendments set forth in the Proposal, we urge it to consider a number of alternative approaches to implementation of the new regulatory regime for affected market participants.

##### **A. Delayed OATS Compliance**

CTC believes that the Commission should postpone member reporting obligations for market participants that are brought under FINRA membership by virtue of the adoption of the Proposal and that are not already OATS compliant. This is necessary in light of the fact that the Commission has mandated the creation of a CAT. As you know, the exchanges have been slow to approve a CAT NMS Plan since the adopting release was issued by the Commission in July of 2012. The member community should not have to bear the expense and burden of implementing compliance with both OATS and CAT as the delay regarding implementation of CAT was caused by the exchanges themselves and not market participants. Further, we believe that implementation of CAT may only be further delayed if the member community becomes OATS compliant, then, in turn, petitions the Commission to extend implementation of CAT to avoid the burden of dual-system implementation. If the true intent and aim of the Commission is to implement CAT, then market participants who will be new FINRA members should not be required to become OATS compliant unless a target date of CAT implementation cannot be reached

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<sup>13</sup> We realize that payment to FINRA by the SROs will be made pursuant to RSAs that are not publicly available.

after a reasonable period of time. This is particularly appropriate for a firm such as CTC, where the benefit of OATS compliance for regulatory and supervisory oversight is negligible, as FINRA already possesses all of CTC's trade data.

#### B. Hedging Activity Exemption

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. The suggested limitation of the hedging exemption in the Proposal does not contemplate these market realities and should be expanded to apply to broker dealers that trade in any options market center, not just trading exclusively on a physical floor.<sup>14</sup>

The options market centers of today are exceedingly electronic; indeed, *nine of the thirteen* SEC-registered options exchanges operate purely on an electronic "floor." In discussing the availability of the hedging exemption, the Proposal references the options exchanges with physical floors – NYSE Arca Options, NYSE Amex Options, NASDAQ OMX Phlx and CBOE – but does not reference the options exchanges that do not have physical floors.<sup>15</sup> On its face, therefore, the Proposal would limit the hedging activity exemption to market participants trading on the floor of these four exchanges.<sup>16</sup> This outcome seems to reflect an arbitrary distinction between the structures of options market centers (i.e., physical vs. electronic) and does not align with the nature of today's options marketplace. Based upon the foregoing, we urge the Commission to expand the hedging activity exemption to apply to broker dealers that trade in any options market center and not just on the physical floor of options market centers.

#### C. Non-FINRA Member Options Market Making Firms that Do Not Trade Off-Exchange but Continue to Trade Through FINRA Member Firms Should Remain Exempt from FINRA Membership

CTC conducts a limited amount of off-exchange trading in the securities markets and does so only to engage in stock hedging activity. Question 45 of the Proposal asks the following in relation to off-exchange trading:

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<sup>14</sup> Proposal at 41.

<sup>15</sup> See Proposal at 41, footnote 119.

<sup>16</sup> The options exchanges that operate in a purely electronic environment include: BATS Options Market, BOX Options Exchange, C2 Options Exchange, International Securities Exchange, ISE Gemini, MIAX Options Exchange, NASDAQ OMX BX, and the NASDAQ Options Market.

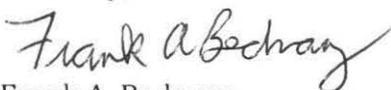
*“Under the proposed amendments to the Rule, a Non-Member Firm that conducts no off-exchange trading, but trades on an exchange of which it is not currently a member, would, in accordance with section 15(b)(8), have to either join an Association or become a member of each exchange upon which it trades. Should the proposed amendments be revised to provide an exemption from Section 15(b)(8) to permit such Non-Member Firm, with no off-exchange trading, to remain exempt from membership in an Association and continue trading on exchanges of which it is not a member, so long as certain conditions are met, such as the exchange of which it is a member entering in to appropriate contractual arrangements such that the exchange is in a position to effectively surveil all of the trading activities of that firm?”*

CTC would support a regulatory regime under which it and other options market makers could continue to trade on exchanges of which it is not a member for the purpose of hedging its options trading activity without having to register with FINRA so long as it ceased conducting any off-exchange trading. The cessation of this off-exchange activity would come at a cost, but that is a cost CTC would be willing to bear for the goal of increased transparency and more open markets.

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CTC appreciates the opportunity to comment on the Proposal. Please do not hesitate to contact me at [REDACTED] if you have questions regarding any of the comments provided in this letter.

Sincerely,



Frank A. Bednarz  
Global Co-Head of Trading

cc: The Honorable Mary Jo White, Chair  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Daniel M. Gallagher, Commissioner  
The Honorable Michael S. Piwowar, Commissioner  
The Honorable Kara M. Stein, Commissioner

Mr. Stephen Luparello, Director, Division of Trading and Markets  
Mr. Gary Goldsholle, Deputy Director, Division of Trading and Markets  
Mr. David S. Shillman, Associate Director, Division of Trading and Markets