

January 8, 2013

Via Electronic Mail ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))

U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090  
Attention: Elizabeth M. Murphy, Secretary

## COMMENT LETTER AND PETITION FOR SUSPENSION AND DISAPPROVAL

**Re: Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend the CBOE Stock Exchange Fees Schedule, File No. SR-CBOE-2012-119, Exchange Act Release No. 34-68417 (Dec. 18, 2012) (the “Rule Filing”)**

Dear Ms. Murphy:

MP Capital<sup>1</sup> (the “Petitioner”) appreciates the opportunity to comment on the above-captioned notice, under which the CBOE Stock Exchange Inc. (the “CBSX”) proposed a rule change to amend the Fees Schedule for itself.<sup>2</sup> The proposed rule change purports to become effective upon filing with the U.S. Securities and Exchange Commission (the “Commission”) under Section 19(b)(3)(A) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).<sup>3</sup> For the reasons set forth below we respectfully petition the Commission to temporarily suspend this rule change under Section 19(b)(3)(C) of the Exchange Act<sup>4</sup> and institute proceedings to disapprove the rule change under Section 19(b)(2)(B) of the Exchange Act.<sup>5</sup>

The Rule Filing seeks a 67% increase to the Initial Regulatory Review Fee and the Monthly Regulatory Fee for CBSX Trading Permit Holders (“CBSX TPHs”) that are not also Chicago Board Options Exchange (“CBOE”) Trading Permit Holders (“CBOE TPHs”) who either apply for CBOE to act as their designated examining authority (“DEA”) or for whom the CBOE acts as a DEA. Both initial and monthly fees are to be raised from \$3,000 to \$5,000. The CBOE handles all regulatory functions for the CBSX.<sup>6</sup> The CBOE is the majority owner of the CBSX.<sup>7</sup>

### **The Rule Filing Fails to Adequately Justify The Fee Increase**

The Rule Filing states that the Fee increase is reasonable because it is needed to offset increased regulatory costs that the CBOE incurs associated with acting as designated examining authority

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<sup>1</sup> MP Capital holds a trading permit on the CBOE Stock Exchange and acts as a liquidity provider in the remote market-maker capacity.

<sup>2</sup> *Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend the CBOE Stock Exchange Fees Schedule*, Exchange Act Release No. 68417; File No. SR-CBOE-2012-119; 77 Fed. Reg. 74894 (Dec. 18, 2012).

<sup>3</sup> 15 U.S.C. § 78s(b)(3)(A).

<sup>4</sup> 15 U.S.C. § 78s(b)(3)(C).

<sup>5</sup> 15 U.S.C. § 78s(b)(2)(B).

<sup>6</sup> Rule Filing

<sup>7</sup> <http://ir.cboe.com/releasedetail.cfm?ReleaseID=609643>

(“DEA”). The Rule Filing fails to provide any details regarding the amount or how the exact source of the increased costs is determined.

Another aspect of the equation to be considered is the substantial increase in revenue the CBOE received from fines in 2012. Between 2011 and 2012, the number of fines has increased by 152% and the amount collected increased by 377%. In 2011 CBOE issued 21 fines totaling \$1,302,500. In 2012 CBOE issued 53 fines totaling \$6,207,500.<sup>8</sup> All revenues received from regulatory fines are applied to fund the legal and regulatory operations of the exchange, including surveillance and enforcement.<sup>9</sup>

The Rule Filing’s lack of transparency into the nature and amount of the increased costs combined with its failure to take into account the increased revenue casts doubt on whether the fee increase is justified from an economical standpoint. By contrast, a rule filing that seeks to raise regulatory fees on a per-contract traded basis was submitted by the International Securities Exchange LLC (“ISE”). It attributes the need for a fee increase to a decline in industry volume.<sup>10</sup>

### **The Rule Filing Fails To Ensure That Fees Are Allocated Equitably Among Users of Exchange Facilities.**

Under the Exchange Act, the Commission has a duty to ensure that exchanges “provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.”<sup>11</sup> Any exchange rule filing that seeks to change fees charged to members must satisfy this rule.

The Rule Filing makes this statement:

“These increases are equitable and not unfairly discriminatory because they will apply to all CBSX TPHs to whom the Initial Regulatory Review Fee and the Monthly Regulatory Fee apply.”

The Petitioner respectfully submits that the Rule Filing does not satisfy the provision that fees must be equitably allocated among all users of an exchange’s facilities for reasons explained below.

The “facilities” under consideration are the resources used to provide the DEA function. The resources likely include personnel, office space, technology infrastructure, etc. As stated earlier in this letter, the CBSX does not employ resources directly; instead it leverages these resources from the CBOE. The facilities under consideration are utilized by both CBSX TPHs and CBOE TPHs.<sup>12</sup>

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<sup>8</sup> <http://www.cboe.com/aboutCBOE/legal/disciplinary.aspx>

<sup>9</sup> Exchange Rule 2.51

<sup>10</sup> *Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Options Regulatory Fee*, Exchange Act Release No. 67087; File No. SR-ISE-2012-43; 77 Fed. Reg. 33535 (May. 31, 2012).

<sup>11</sup> 15 U.S.C. § 78f(b)(4).

<sup>12</sup> <http://www.cboe.com/AboutCboe/legal/departments/orsareg.aspx>

Users of CBOE DEA facilities fall into three categories based on whether they are a CBOE TPH, a CBSX TPH or both:

User Category	CBSX TPH?	CBOE TPH?	Subject To Proposed Fee Increase?	Effective Fee Schedule
1	Yes	No	Yes	CBSX
2	No	Yes	No	CBOE
3	Yes	Yes	No	CBOE

From the standpoint of paying for DEA services, the Rule Filing fails to ensure that fees are equitably allocated because the fee increase applies only to category #1 of users of CBOE DEA facilities, but not the other two categories of users.

CBOE Fee schedule indicates that DEA services are priced at \$0.60 per \$1000 of gross revenue subject to a minimum of \$400 for non-clearing firms per month.<sup>13</sup>

DEA services provided by the CBOE DEA facilities cost as follows:

- \$5000/month for any firm in Category 1
- \$400/month for a firm in Category 2 or 3 with no revenue
- \$5000/month for a firm in Category 2 or 3 with \$100,000,000 annual revenue

Some glaring inequities emerge:

- A firm with no revenue in Category 1 would pay a fee 11.5 times higher than a firm with no revenue in category 2 or 3 would pay.
- A firm with annualized revenue of \$100 million in category 2 or 3 would pay the same amount as a firm with no revenue in category 1.

There is another aspect of the Rule Filing that makes it inequitable to some CBSX TPHs. It is generally accepted that CBSX TPHs vary in size and complexity. Larger firms with more employees, business activities, offices, etc. will naturally require more DEA resources than smaller firms to ensure the same level of regulatory oversight.

The CBOE annual examination covers these areas:<sup>14</sup>

- Net Capital
- Books and Records
- AML
- Fingerprints, applications, ITSFEA
- Reg. SHO
- Ownership, financing
- Supervision

<sup>13</sup> <http://www.cboe.com/publish/feeschedule/CBOEFeeSchedule.pdf>

<sup>14</sup> <http://www.cbsx.com/Regulation/CBSXRegProgram091310.pdf> page 11

Consider two hypothetical firms, a larger firm with 100 employees and a smaller firm with three employees. If both firms experience 10% growth in business, it might add 10 new employees to the larger firm and likely leave the head count at smaller firm unchanged. The annual examination for the larger firm will now consume more DEA resources than before. If the DEA fees are raised to offset the cost of the additional DEA resources for the larger firm's annual examination and if the fees are increased equally, the larger firm will receive an unjustified discount while the smaller firm is covering the cost of its larger competitor.

Notice that unlike the CBSX fee schedule, the CBOE DEA fee is structured in a way that addresses the inequity due to firm size. CBOE DEA fees are assessed based on a broker-dealer's revenue. Firms with more revenue will pay proportionally higher fees. Larger firms will generally have higher revenue and therefore pay higher fees.

From the standpoint of receiving DEA services, the Rule Filing fails to ensure that fees are equitably allocated because the same fee increase applies to all firms regardless of the amount of DEA resources that are actually consumed.

By contrast, the previously mentioned ISE Rule Filing ensures fairness by "assessing higher fees to those member firms that require more Exchange (ISE) regulatory services based on the amount of customer options business they conduct".<sup>15</sup>

### **The Rule Filing Raises The Barrier Of Entry For Small Firms**

Petitioner respectfully submits that the Rule Filing acts against the public interest because it raises the barrier of entry for small firms.

It is well documented and universally accepted that small businesses play an important role in our economy's innovation, growth and employment. Having many small broker dealer firms participate in our market system serves the public interest and creates tremendous benefits to long term investors through product innovation and competitive pricing pressures.

The Small Business Regulatory Enforcement Fairness Act (SBREFA) states among other things:<sup>16</sup>

- (1) a vibrant and growing small business sector is critical to creating jobs in a dynamic economy;
- (2) small businesses bear a disproportionate share of regulatory costs and burdens;

A fee schedule that disproportionately burdens small firms raises the barrier of entry and ability for small firms to compete and sustain operations.

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<sup>15</sup> *Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Options Regulatory Fee*, Exchange Act Release No. 67087; File No. SR-ISE-2012-43; 77 Fed. Reg. 33535 (May. 31, 2012).

<sup>16</sup> <http://www.sba.gov/advocacy/825/12186>

As a note, even some of the present largest firms were able to get their start as a small firm because the barrier of entry was not prohibitive.

### **Proposed Fee Increase Creates a Significant Burden Affected On Broker-Dealers And Undermines Their Ability To Compete**

The Rule Filing must include a Statement on Burden on Competition describing the anticipated burden to competition that it will create and the categories or persons or types of business that will be impacted.<sup>17</sup>

The Rule Filing's Statement on Burden and Competition states:

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 Petitioner disagrees with this assessment.

The Rule Filing places CBSX TPHs who receive DEA services from the CBSX at a deep competitive disadvantage because their fixed regulatory costs will be substantially higher than those of broker-dealers that receive DEA services elsewhere. CBSX TPH members are already paying 50% more than the next most expensive DEA service shown, but the proposed fee increase in the Rule Filing would make the CBSX DEA fees 2½ times as high as the next most expensive DEA fee shown.

DEA services pricing from various SROs:

- CBSX - \$5,000/month (Proposed), \$3,000/month (Current)
- NYSE ARCA Stock - \$2,000/month<sup>18</sup>
- NYSE ARCA Options - \$2,000/month<sup>19</sup>
- NYSE AMEX - \$0.00040/dollar of gross revenue (minimum \$275/month for non-clearing firms)<sup>20</sup>
- Chicago Stock Exchange (CHX) - \$1,200/month<sup>21</sup>
- Nasdaq OMX BX (formerly Boston Stock Exchange) - \$4,000/year<sup>22 23</sup>

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<sup>17</sup> <http://www.sec.gov/about/forms/form19b-4.pdf> Page 12.

<sup>18</sup> [http://www.nyse.com/pdfs/NYSEArca\\_Equities\\_Fees.pdf](http://www.nyse.com/pdfs/NYSEArca_Equities_Fees.pdf)

<sup>19</sup> [http://www.nyse.com/pdfs/Options\\_Fee\\_Schedule.pdf](http://www.nyse.com/pdfs/Options_Fee_Schedule.pdf)

<sup>20</sup> [http://globalderivatives.nyx.com/sites/globalderivatives.nyx.com/files/nyse\\_amex\\_options\\_fee\\_schedule\\_010213.pdf](http://globalderivatives.nyx.com/sites/globalderivatives.nyx.com/files/nyse_amex_options_fee_schedule_010213.pdf)

<sup>21</sup> *Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Alter Its Fee Schedule To Increase Its DEA Fees*, Exchange Act Release No. 34-68181; File No. SR-CHX-2012-17; 77 Fed. Reg. 68185 (November 8, 2012).

<sup>22</sup> \$4,000/year at the highest tier based on number of orders submitted daily

<sup>23</sup> *Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Eliminate the Fees Under Rule 7003(b) and Adopt a New Equities Regulatory Fee*, Exchange Act Release No. 34-67046; File No. SR-BX-2012-031; 77 Fed. Reg. 31906 (May 23, 2012).

The price list should not be construed to imply that a broker-dealer can simply choose another DEA service to take advantage of a lower fee. On the contrary, when a broker-dealer becomes a member of any SRO for the first time, that SRO will provide DEA services and will continue to do so even if the broker dealer becomes a member of other exchanges.

A CBSX TPH that currently receives DEA services from CBSX has no alternative but to pay the proposed fee increase, while other broker-dealers can take advantage of lower DEA fees by investing savings into hiring personnel, expanding infrastructure or increasing trading capital. Over the long term, the burden of the proposed fee increase will have a significant adverse impact on the ability of any affected broker-dealer to compete.

## **CONCLUSION**

Petitioner respectfully submits that the Rule Filing fails to justify the need for a fee increase. Rule Filing cites increased costs but fails to recognize substantially increased revenues collected in the form of regulatory fines.

Petitioner respectfully submits that the Rule Filing is inconsistent with the provisions of 15 U.S.C. § 78f(b)(4) because it will magnify the fee allocation inequity by giving advantage to larger firms that are CBOE TPHs over smaller firms that are CBSX TPHs and that is not in keeping with the provision that exchange costs be allocated equitably.

Petitioner respectfully submits that the Rule Filing is not in the public interest because it raises the barrier of entry to small businesses and is therefore inconsistent with 15 U.S.C. § 78s (b)(3)(C).

Petitioner respectfully submits that the Rule Filing's Statement on Burden and Competition fails to recognize and take into account the impact the proposed fee increase on broker-dealers that would be forced to pay this increase. The affected broker-dealers will spend substantially more on DEA services than unaffected broker-dealers which will leave them less capital to invest and limit their ability to compete.

For the foregoing reasons, Petitioner respectfully requests that the Commission suspend the operation of the Rule Filing and disapprove it.

Sincerely,

Dmitry Pargamanik  
William McBride  
Seva Zaslavsky

For MP Capital

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