

EXECUTE SUCCESS™

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**Via Electronic Mail**

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549-1090  
[Rule-Comments@SEC.GOV](mailto:Rule-Comments@SEC.GOV)

Re: Second Response to Comment Letters on File No. SR-CBOE-2014-040

Dear Ms. Murphy:

Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) submits this letter in response to the comments submitted to the U.S. Securities and Exchange Commission (“SEC” or “Commission”) by the Financial Information Forum (“FIF”)<sup>1</sup> on the above-referenced rule filing in which CBOE proposes to add a new tied to stock order type that includes a marking requirement and to adopt a new reporting requirement for the stock component of tied to stock orders.

Reporting Format

FIF Letter #2 states that FIF performed a preliminary review of the proposed reporting format for the new stock reporting requirement, including a gap analysis of the existing reporting format for CBOE Rule 8.9(b) reports (“Rule 8.9(b) Reports”) against the proposed reporting format for the reporting of stock components.<sup>2</sup> FIF continued that it expected the reporting format to be substantially similar to the layout for the reporting requirement under Rule 8.9(b) based on the text of proposed Rule 15.2A, Interpretation and Policy .03.<sup>3</sup> FIF notes that the proposed stock reporting requirements includes new and different elements than the Rule 8.9(b) Reports, some of which it believes require additional explanation, and that it was unclear to FIF as to why fields not required for the proposed stock reporting were included in the proposed format. FIF concludes that the proposed reporting format raises implementation concerns.

CBOE currently permits Clearing Trading Permit Holders (or Market-Makers to the extent a Clearing Trading Permit Holder does not report a trade on behalf of a Market-Maker) to submit Rule 8.9(b) Reports in one of two different formats (currently, each Clearing Trading Permit Holder may

<sup>1</sup> Letter from FIF to Elizabeth M. Murphy, dated July 18, 2014 (“FIF Letter #2”). FIF submitted previous comments to SR-CBOE-2014-040 (see Letter from FIF to Elizabeth M. Murphy, dated June 13, 2014 (“FIF Letter #1”)), as did the Chicago Stock Exchange, Inc. (“CHX”) (see Letter from CHX to Elizabeth M. Murphy, dated June 9, 2014 (“CHX Letter”)). CBOE submitted a response to those comments. See Letter from CBOE to Elizabeth M. Murphy, dated July 15, 2014 (“CBOE Letter #1”).

<sup>2</sup> See Regulatory Circular RG14-110 (dated July 10, 2014).

<sup>3</sup> Proposed Rule 15.2A, Interpretation and Policy .03 states that “a Market-Maker (or its clearing firm) may include the information required by Rule 15.2A in the equity reports submitted to the Exchange pursuant to Rule 8.9(b).”

determine which format to use).<sup>4</sup> The gap analysis that FIF performed was done with the “older format” for Rule 8.9(b) Reports, while the proposed stock reporting format is substantially similar to the “newer format.” The Exchange is in the process of migrating the reports from the older format to the newer format and intends to phase out the older format. The proposed stock reporting requirement is based on the newer format (which in the future will be the required format for Rule 8.9(b) Reports). Additionally, as mentioned in Regulatory Circular RG14-110, the proposed data layout requirements are a component of broader requirements for other regulatory request data submissions.<sup>5</sup> Because the broader layout requirements will apply to a larger subset of reports and apply to all Trading Permit Holders, the proposed stock reporting requirement is consistent with these broader requirements.

The Exchange is reviewing FIF’s questions regarding some of the elements of the proposed stock reporting format and, if it deems necessary to provide additional detail regarding those and other elements, may issue another Regulatory Circular. While the proposed reporting requirement format includes more fields than the older format of Rule 8.9(b) Reports, neither proposed Rule 15.2A, Interpretation and Policy .03 nor Regulatory Circular RG14-110 requires Trading Permit Holders to include those additional fields on Rule 8.9(b) Reports to the extent Market-Makers rely on proposed Interpretation and Policy .03 to satisfy the proposed stock reporting requirement. The Exchange notes that the Exchange included the flexibility for Trading Permit Holders to have their Clearing Trading Permit Holders submit the reports on their behalf, including proposed Interpretation and Policy .03, and other provisions in the proposed rule change in response to previous FIF comments (and comments from other industry participants). The Exchange did so in order to accommodate Trading Permit Holders and reduce any potential burdens imposed by the proposed rule change but still expects to receive benefits from the proposed rule change (as further discussed below). Therefore, regardless of whether a Market-Maker (or its Clearing Trading Permit Holder) uses the older format or newer format for Rule 8.9(b) Reports, those reports will satisfy the proposed stock reporting requirement even though they may not include all of the data elements set forth in Regulatory Circular RG14-110. In other words, to the extent Rule 8.9(b) Reports include information for all stock transactions of Market-Makers, Market-Makers will have no additional requirements under proposed Rule 15.2A.

While other Trading Permit Holders that are not subject to Rule 8.9(b) may have to perform system work to comply with proposed Rule 15.2A, as discussed above, this work will likely overlap with system work related to reports required by Rule 17.2, Interpretation and Policy .04. As noted in CBOE Letter #1, the rule filing provides that CBOE will announce the implementation date of the reporting requirement no later than 90 days following the effective date of the rule filing, which implementation date will be no later than 180 days following the effective date of the rule filing.<sup>6</sup> CBOE reiterates that it will accept feedback from Trading Permit Holders regarding the timing of the implementation date, but the Exchange believes the proposed time frame provides Trading Permit Holders that need to perform system work to be able to comply with the proposed rule change with sufficient time to do so.

As the Exchange notes in the rule filing and CBOE Letter #1, the proposed rule change will enhance CBOE’s audit trail, particularly with respect to cross-market trading activity. While the proposed reporting requirement may impose upfront costs on Trading Permit Holders, the Exchange believes this is offset by the future benefits provided by the proposed rule filing. Currently, Exchange

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<sup>4</sup> The Exchange notes that there are Clearing Trading Permit Holders that use the “older format” and Clearing Trading Permit Holders that use the “newer format.” The Exchange also notes that, similar to the proposed rule change, Rule 8.9(b) allows the Exchange to determine the manner of Rule 8.9(b) Reports.

<sup>5</sup> Rule 17.2, Interpretation and Policy .04 permits the Exchange to determine the form and manner of such reports (which format the Exchange intends to announce in a Regulatory Circular).

<sup>6</sup> See SR-CBOE-2014-040 at 15 – 16.

surveillances monitor Trading Permit Holders' cross-market trading activity. If the surveillances detect a potential violation, the Exchange receives an alert, at which point the Exchange investigates the trading activity. In connection with these efforts, the Exchange often requests transaction information on an ad hoc basis from Trading Permit Holders. This is both costly and time-consuming for Trading Permit Holders, as well as the Exchange, due to the inconsistent format of the information submitted and the manual processing of such information. Regularly, after receiving this information, the Exchange determines that there is a reasonable basis to conclude that no further action is warranted with respect to that surveillance alert. The Exchange believes that the information it will receive through the proposed stock reports, in connection with the tied to stock indicator, will significantly reduce the number of ad hoc requests it must make from Trading Permit Holders, as it will already have the stock transaction information necessary to make a similar determination with respect to that surveillance alert.<sup>7</sup> For example, suppose an option trade is part of an alert received by the Exchange from its front-running surveillance. If the option is marked as a tied to stock order and the Exchange has the information for the related stock execution pursuant to the proposed reporting requirement, the Exchange may evaluate the reported stock order size, price and time of execution contained in that report, which readily allows CBOE to evaluate the information and potentially come to a similar conclusion without further involvement of the Trading Permit Holder.

FIF also commented that it believes the Commission should require the release of the form and manner of reporting requirements prior to the adoption of rules. As indicated in CBOE Letter #1, and as acknowledged in FIF Letter #2, it is common practice for exchanges, including CBOE, to specify the form and manner of reports required to be provided to the Exchange, which is generally done through Regulatory Circulars.<sup>8</sup> Technology is constantly changing, and the Exchange regularly evaluates ways in which it may improve reporting formats to both its and Trading Permit Holders' benefits. When the Exchange identifies such improvements, it releases updates to the format. If exchanges were required to submit the form and manner of reporting requirements for Commission approval, the frequency with which they would need to seek this approval would render any benefits of improved formats moot. The form and manner of reporting requirements include a great amount of detail, far more than is included in the rules of any exchanges, thus the Exchange believes it would be inappropriate to add that to the rule-making process.<sup>9</sup>

As indicated in CBOE Letter #1, the proposed rule change is consistent with current and long-standing practice of announcing the form and manner of reporting requirements by Regulatory Circular to accommodate the technical detail of and regular changes to these formats. CBOE generally provides sufficient implementation time for changes to reporting formats to accommodate Trading Permit Holders (as it does in the rule filing) and will continue to do so. CBOE appreciates any feedback on reporting formats its releases, whether it is the initial format or an update to the existing format. However, like other rules, the proposed rule change provides the Exchange with authority to issue and modify the

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<sup>7</sup> The Exchange notes that it may still need to request information from Trading Permit Holders in connection with cross-market trading or other rules and regulations, and the Exchange may still determine that certain trading activity constitutes a violation of federal laws, rules and regulations as well as Exchange rules even though it determines that a stock transaction that was reported was coupled with a tied to stock order. However, the Exchange believes that the proposed rule change will reduce the number of reviews that it will need to conduct.

<sup>8</sup> See, e.g., CBOE Rules 6.24, 6.51(b) and 24.4, Interpretation and Policy .03.

<sup>9</sup> With respect to the comment in FIF Letter #2 regarding Chairwoman White's speech regarding the interaction of regulation and technology, the Exchange notes that the format of the proposed stock reporting requirement involves post-trade reporting and does not involve the level of risk that accompanies technology related to pre-trade controls and executions.

reporting format by Regulatory Circular.<sup>10</sup> Therefore, CBOE believes the rule filing may be approved in its current format.

#### Number of Tied to Stock Transactions

FIF Letter #2 requests that CBOE amend the rule filing to discuss scenarios in detail regarding who has reporting responsibility under Rule 15.2A. The rule filing very clearly states that *each Trading Permit Holder* must comply with the proposed reporting requirement for the executed stock or convertible security legs of “tied to stock orders *that the Trading Permit Holder executed on the Exchange that trading day*” (emphasis added). This includes Trading Permit Holders that act as floor brokers. Therefore, the Exchange does not believe an amendment to the filing is necessary.

FIF Letter #2 also comments that it believes the number of tied to stock transactions is very small. While the Exchange does not know the exact volume of tied to stock transactions, its self-regulatory obligations require it to monitor all types of trading activity, including order types that may represent a smaller amount of the Exchange’s volume. The Exchange has identified an area in which it can enhance its audit trail, and the proposed rule change is intended to implement that enhancement. While it may cover an area that involves a smaller transaction volume, the Exchange feels the enhancement is reasonable and appropriate to assist in its efforts to monitor that area for potential violations of federal rules and regulations and Exchange rules.

In addition, FIF Letter #2 references a current reporting requirement with respect to Qualified Cross Contingent (“QCC Orders”) set forth in Regulatory Circular 13-102 and questions the need for an implementation effort to only incrementally improve CBOE’s audit trail. Again, CBOE has identified a way to enhance its audit trail, and it is not in FIF’s purview to decide that the enhancement is only “incremental.” While Regulatory Circular 13-102 does include a reporting requirement for QCC transactions, the proposed rule change will supersede that requirement upon implementation to achieve the enhancements described above. As discussed above, the Exchange expects the “extensive implementation effort” referenced by FIF to ultimately be required for other regulatory reporting requirements to which all Trading Permit Holders will be subject under Rule 17.2, Interpretation and Policy .04, as well as the transition from the older format to newer format of Rule 8.9(b) Reports. In addition, as also discussed above, the Exchange expects any implementation effort to be offset by the ability of Market-Makers (through their Clearing Trading Permit Holders if they so choose) to satisfy the proposed stock reporting requirement through Rule 8.9(b) Reports (whether the older or newer format is used) and fewer costly and time-consuming ad hoc requests for information.

#### CHX Proposal

FIF Letter # 2 also comments that the proposal in the CHX Letter merits additional discussion. As indicated in CBOE Letter #1, CBOE appreciates the support for enhancements to its audit trail with respect to cross-market trading activity and welcomes the opportunity to coordinate with other exchanges to identify methods that may create further enhancements and regulatory efficiencies with respect to such activity. However, the Exchange believes this type of cooperative effort would take time to implement. FIF is welcome to contact CHX directly to discuss the CHX’s proposal. FIF Letter #2 comments that “the effort required to achieve the CHX proposal may not be significantly different and may even be simpler than the Exchange’s current proposal.” CBOE notes that FIF Letter #1 indicated that it could not determine the true cost of CBOE’s proposal until it reviewed the reporting format for the proposal. CBOE is unsure of how FIF is able to determine that the CHX proposal (which was a very brief,

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<sup>10</sup> See SR-CBOE-2014-040 at 4 and note 6.

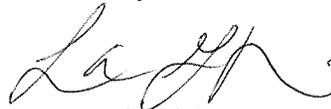
theoretical proposal that included far less detail than CBOE's proposal, much of which detail was included in response to FIF's previous comments) can make such a statement at this time.

As stated in CBOE Letter #1, CBOE's current proposal identifies an opportunity to enhance CBOE's audit trail in the short-term, and CBOE believes it is necessary to proceed with the rule filing as proposed. To the extent there is an industry-wide effort to identify further opportunities for enhancements in the future, CBOE will gladly cooperate with such an effort and further modify its rules as appropriate in coordination with such an effort.

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CBOE respectfully requests that the Commission approve the proposed rule change. Should you require any further information, please do not hesitate to contact the undersigned.

Sincerely,



Laura G. Dickman

Attachment

cc: Mr. David Hsu, SEC  
Ms. Yvonne Fraticelli, SEC  
Ms. Susie Cho, SEC  
Mr. Charles Sommers, SEC  
Legal Division, CBOE