

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63314; File No. SR-CBOE-2010-084)

November 12, 2010

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change Regarding Registration and Qualification Requirements for Associated Persons

I. Introduction

On September 10, 2010, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to apply its registration and qualification requirements to all of its members. The proposed rule change was published for comment in the Federal Register on September 28, 2010.³ The Commission received two comment letters on the proposal.⁴ This order approves the proposed rule change.

II. Background

Currently, registration, examination, and continuing education requirements for associated persons of trading permit holder⁵ organizations (“TPH organizations”) that conduct a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 62977 (September 22, 2010), 75 FR 59773 (“Notice”).

⁴ See letter from Frank Vivirito, Chief Compliance Officer, XR Securities LLC, to Elizabeth M. Murphy, Secretary, Commission, dated October 14, 2010 (“XR Securities Letter”) and letter from J. Micah Glick, Chief Compliance Officer, Cutler Group LP, to Elizabeth M. Murphy, Secretary, Commission, dated October 22, 2010 (“Cutler Letter”).

⁵ Section 1.1 of CBOE’s By-Laws provides: “The term ‘Trading Permit Holder’ means any individual, corporation, partnership, limited liability company or other entity authorized by the rules that holds a Trading Permit. If a Trading Permit Holder is an individual, the Trading Permit Holder may also be referred to as an ‘individual Trading Permit Holder.’ If a Trading Permit Holder is not an individual, the Trading Permit Holder may also be

public customer business are in Chapter IX, Doing Business with the Public, of CBOE’s rules.⁶

The associated persons of TPH organizations register with the Exchange via the Uniform Application for Securities Industry Registration or Transfer (“Form U4”) through the Financial Industry Regulatory Authority’s (“FINRA”) Central Registration Depository System (“WebCRD”), and must pass the General Securities Representative examination (“Series 7”) to function as representatives; if acting as options principals engaged in the supervision of options sales practices, they must also pass the Registered Options Principal examination (“Series 4”) or the General Securities Sales Supervisor examination (“Series 9/10”).

Rule 3.6A, Qualification and Registration of Certain Associated Persons, sets forth the requirement for each individual TPH or TPH organization subject to Rule 15c3-1 under the Act to have a FINOP (Limited Principal - Financial and Operations).⁷ Rule 3.6A also references the registration requirements set forth in Chapter IX of CBOE’s Rulebook for associated persons of TPH organizations that conduct a public customer business.⁸

Rule 9.3A, Continuing Education for Registered Persons, applies to registered persons of TPHs and TPH organizations that conduct business with the public and sets out CBOE’s

referred to as a ‘TPH organization.’ A Trading Permit Holder is a ‘member’ solely for purposes of the Act; however, one’s status as a Trading Permit Holder does not confer on that Person any ownership interest in the Exchange.” See Section 3(a)(3)(A) of the Act which defines member of an exchange.

⁶ Before CBOE demutualized, Rule 3.1(a) required every individual member or member organization to have as the principal purpose of its membership the conduct of a public securities business.

⁷ The Exchange is proposing to apply the existing FINOP requirement in Rule 3.6A to all TPH organizations.

⁸ CBOE has represented that CBOE Stock Exchange (“CBSX”) firms solely engage in proprietary trading. Chapter IX of CBOE’s Rulebook pertains to TPHs that conduct a public customer business and is not included in Appendix A, Applicability of Rules of the Exchange, to the CBSX rules, which lists the CBOE rules that apply to CBSX TPHs. However, it is the Commission’s understanding that it is CBOE’s intent to apply the rules of Chapter IX that are referenced in Rule 3.6A to CBSX TPHs.

continuing education requirements.

III. Description of the Proposal

CBOE proposes to amend its rules and the rules of the CBSX regarding registration, qualification, and continuing education requirements for individual TPHs and associated persons⁹ of TPHs. CBOE is amending its rules to make them substantially similar to the registration, examination and continuing education requirements of FINRA. Specifically, CBOE proposes to require all individual TPHs and TPH associated persons, regardless of whether they conduct a public customer or proprietary securities business, to register, qualify and comply with continuing education requirements.¹⁰

CBOE and CBSX will require all individual TPHs and individual associated persons¹¹ not already registered in WebCRD to register under Rule 3.6A within 60 days of the date of this Order (January 11, 2011) and to pass a qualification examination. CBOE is developing an alternative to the Series 7 examination that is specifically tailored toward individual TPHs and associated persons of TPHs that are engaged in proprietary trading. CBOE has represented that within six months of the date of this Order it will have completed the development of this

⁹ Section 3(a)(18) of the Act defines an associated person of a broker or dealer as “any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with such broker or dealer, or any employee of such broker or dealer, except that any person associated with a broker or dealer whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b).” 15 U.S.C. 78c(a)(18).

¹⁰ It is the Commission’s understanding that, with these changes to CBOE’s rules, all associated persons involved in the securities business of a firm that does business on the CBOE will have to register, pass a qualification examination and comply with continuing education requirements.

¹¹ Associated persons of CBOE TPHs include both individuals and non-natural persons.

qualification examination¹² and will file the examination with the Commission. All individual TPHs and individual associated persons must take and pass the new examination, as applicable, no later than August 12, 2011.

Rule 3.6A(c) will require that each TPH and TPH organization designate on Schedule A of Form BD a Chief Compliance Officer (“CCO”)¹³ who must register with CBOE using Form U4 and pass the Compliance Official examination (“Series 14”).¹⁴ CBOE has represented to the Commission that it has asked FINRA to enable this category of registration for CBOE and to make the Series 14 examination available to CCOs of CBOE and CBSX TPHs. CBOE is also proposing to allow a limited exemption from the requirement to pass the Series 14.¹⁵

¹² CBOE has represented that it is developing a principal examination tailored to sole proprietors, officers, partners, and directors, individual TPHs or individual associated persons who are engaged in the supervision or monitoring of proprietary trading, market-making, or brokerage activities, and/or anyone who is engaged in the supervision or training of those engaged in proprietary trading, market-making or brokerage activities. Until this examination is complete and filed with the Commission, these associated persons must pass the General Securities Principal examination (“Series 24”).

¹³ CBOE indicated that it did not want to use the term “principal” in Rule 3.6A to denote associated persons of a member who are actively engaged in the management of the member's investment banking or securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions.

Under CBOE’s proposed rules anyone functioning as a principal must register as such with the Exchange via a Form U4 through FINRA’s WebCRD. CBOE did not want to use the term principal in Rule 3.6A to refer to these associated persons because it wanted to avoid creating confusion for its TPHs that have Registered Options Principals. Through this filing, CBOE is essentially extending the Registered Options Principal category and requirements (though not the same examinations) to those associated persons in a supervisory function whose firms do not conduct business with the public. Ultimately, the Commission expects CBOE to eliminate the distinction in its rules relating to doing business with the public. Hereinafter, the Commission will refer to such persons as principals.

¹⁴ See NASD Rule 1022(a)(1)(c).

¹⁵ See proposed Rule 3.6A(c).

Furthermore, the Exchange is proposing to add Interpretations and Policies .07 to Rule 3.6A requiring the registration and the successful completion of a heightened qualification examination by every individual acting in any of the following capacities: (i) officer; (ii) partner; (iii) director; (iv) supervisor of proprietary trading, market-making or brokerage activities; and/or (v) supervisor of those engaged in proprietary trading, market-making or brokerage activities with respect to those activities. Thus, all individuals who engage in supervisory functions at the TPH organization's securities business, or who oversee associated persons of TPHs, must register and pass the relevant principal examination.¹⁶ The rule also requires each TPH organization to have at least two of the above listed individuals registered as principals and subject to the relevant principal examination requirement. The Exchange may waive the requirement to have two principals registered if a TPH organization conclusively demonstrates that only one principal should be required to register (such as a single member liability company).¹⁷

A TPH organization that is involved solely in proprietary trading¹⁸ and has 25 or fewer associated persons would only be required to have one principal registered and subject to a heightened qualification examination under this section.¹⁹

Rule 3.6A(a)(1) provides that a TPH or TPH organization shall not maintain a registration with the Exchange for any person: (1) who is no longer active in the TPH or TPH

¹⁶ The Commission understands that this will be either an appropriate examination developed by CBOE and filed with the Commission or the Series 24.

¹⁷ The Commission expects this waiver to be used in very limited circumstances.

¹⁸ Interpretations and Policies .07 to Rule 3.6A defines proprietary trading.

¹⁹ See proposed Interpretations and Policies .07 to Rule 3.6A. The Commission understands that this examination will be the Series 24 until CBOE has completed and filed with the Commission its own examination for principals of proprietary trading firms. This requirement is substantially similar to NASDAQ Rule 1021(e)(1).

organization's securities business; (2) who is no longer functioning in the registered capacity; or (3) where the sole purpose is to avoid an examination requirement. A TPH or TPH organization cannot register any person where there is no intent to employ that person in the TPH or TPH organization's securities business. However, a TPH or TPH organization may maintain or make application for the registration of an individual who performs legal, compliance, internal audit, back-office-operations, or similar responsibilities for the TPH or TPH organization, or a person who performs administrative support functions for registered personnel, or a person engaged in the securities business of a foreign securities affiliate or subsidiary of the TPH or TPH organization.²⁰

The Exchange is also proposing to add Rule 3.6A(a)(2) to identify several categories of individual TPHs and individual associated persons who are exempt from the new registration requirements. The categories are: (i) individual associated persons functioning solely and exclusively in a clerical or ministerial capacity; (ii) individual TPHs and individual associated persons who are not actively engaged in the securities business, (iii) individual TPHs and individual associated persons functioning solely and exclusively to meet a TPH or TPH organization's need for nominal corporate officers or for capital participation; and (iv) individual associated persons whose functions are solely and exclusively related to transactions in commodities, transactions in security futures and/or effecting transactions on the floor of another national securities exchange and who are registered as floor members with such exchange.²¹

²⁰ This rule is substantially similar to NASD Rule 1021(a).

²¹ This rule is substantially similar to NASD Rule 1060.

Rule 3.6A(e) addresses lapses in registration²² and Interpretation and Policies .05 thereto would permit CBOE to waive the examination requirement in limited circumstances.²³ In addition, the Exchange is making certain technical and non-substantive changes to its rules.²⁴

The Exchange states that individual associated persons, including Registered Options Principals and Registered Representatives, continue to be subject to the registration, examination and continuing education requirements of Chapter IX of CBOE's rules, which apply to firms conducting a public customer business.²⁵ Additionally, any TPH or TPH organization that ends the employment of an individual required to register under Rule 3.6A must comply with the requirements in Chapter IX of CBOE's rules.

The Exchange proposes to require individual TPHs and individual associated persons whose activities are limited solely to the transaction of business on the floor with TPHs or registered broker-dealers to fulfill continuing education requirements.²⁶

IV. Comment Letters

The Commission received two comment letters on the proposed rule change.²⁷ One commenter, XR Securities, stated that the examination proposed to be developed by CBOE for associated persons was redundant for associated persons currently registered with another exchange who have passed the Series 7. The commenter stated that the new examination would

²² This rule is substantially similar to NASD rules 1021(c) and 1031(c) regarding lapses.

²³ This rule is substantially similar to NASD Rule 1070 regarding waivers.

²⁴ See Notice at pp. 8-9.

²⁵ See supra note 8.

²⁶ Interpretations and Policies .01 to Rule 9.3A currently excludes these persons from the continuing education requirements set forth in Rule 9.3A. Proposed Interpretations and Policies .04 to Rule 3.6A states that all persons required to register are subject to CBOE's continuing education requirements.

²⁷ See supra note 4.

impose an unfair burden on firms registered at CBOE and elsewhere, and argued that it would be better to allow associated persons registered at more than one exchange to take the Series 7 instead of the proposed CBOE examination. The commenter also stated that the Series 24 is generally accepted by all exchanges as the CCO examination, whereas the Series 14 is available for FINRA/NYSE members to elect to take instead of the Series 24. The commenter believes that requiring a CCO who currently is Series 24 registered to pass the Series 14 would be unreasonable.

The second commenter, Cutler, is supportive of the proposed rule change requiring all traders to register with CBOE and pass a relevant trading examination; however, it also expressed concern over the proposed examination requirements and timeframe for completing a required examination. In short, Cutler believes no new examination requirement should be imposed on traders currently properly registered with CBOE. It suggested creating a new continuing education module for CBOE traders, to the extent the existing examinations do not cover relevant material that would be included in the new examination. For persons to be qualified on CBOE in the near future, Cutler supports CBOE's plan to create an examination specific and relevant to professional traders in lieu of the Series 7, which it considers too broad. Cutler echoed XR Securities' concerns regarding the Series 14 examination for CCOs, stating that the Series 24 is the accepted examination for CCOs and should be adopted by CBOE instead, and, similarly, encouraged CBOE to create an exam to succeed the Series 24 for supervisors whose functions are limited to the supervision of traders.

V. Discussion

The Commission is sympathetic to the concerns raised by the two commenters regarding associated persons who are currently Series 7 qualified who do not want to have to take the

proposed CBOE proprietary trading exam, as well as associated persons who have already qualified as CCOs. The Commission expects that such persons may be eligible for a waiver of the exam requirement if they are able to demonstrate to the CBOE's satisfaction that they are appropriately qualified to do business on the CBOE. However, the Commission believes that this proposed rule change is an important step towards harmonizing the registration, qualification and continuing education requirements across the SROs. In order to meet its obligations under Section 6(b)(1) of the Act to enforce compliance by member firms²⁸ and their associated persons with the Act, the rules thereunder, and the exchange's own rules,²⁹ an exchange must have baseline registration and qualification requirements for all persons conducting business on an exchange, as well as for those supervising such activity. Further to those provisions, the Commission believes an exchange should require continuing education for registered persons to help ensure that members and persons associated with members are up to date on changes to exchange rules and the securities laws, rules, and regulations that govern their activities. In addition, an exchange must know if an associated person of a member firm is subject to a statutory disqualification. This information is elicited by the Form U4, which is used by most exchanges and FINRA to register associated persons. The Commission believes that it is important to ensure that information, such as whether an associated person is subject to a statutory disqualification, is available to exchanges and other regulators, including the Commission and the state securities regulators, through WebCRD, as well as members of the

²⁸ Brokers and dealers are required to supervise the activities of their associated persons. See 15 U.S.C. 78o(b)(4)(E).

²⁹ Section 6(b)(1) requires exchanges to have the ability to enforce compliance by their members and associated persons with the federal securities laws and with their own rules. 15 U.S.C. 78f(b)(1).

public through BrokerCheck, which derives its information from WebCRD.³⁰

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,³¹ and, in particular with Section 6(b)(5) of the Act,³² which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanism of, a free and open market and a national market system and, in general, to protect investors and the public interest. The Commission believes that the proposed rule change is also consistent with Section 6(c)(3)(B) of the Act,³³ which authorizes exchanges to prescribe standards of training, experience and competence for persons associated with exchange members, and gives exchanges the authority to bar a natural person from becoming a member or a person associated with a member, if the person does not meet the standards of training, experience and competence prescribed in the rules of the exchange.

CBOE's proposed rule change requires all associated persons of TPHs engaged in a securities business on CBOE or on CBSX, as well as those who supervise, train or otherwise oversee those who do, to register with the Exchange via the Form U4, qualify by passing an appropriate examination, and be subject to continuing education requirements.³⁴ The

³⁰ See Section 6(c)(2) of the Act, 15 U.S.C. 78f(c)(2); and Rule 19h-1 under the Act, 17 CFR 240.19h-1.

³¹ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

³² 15 U.S.C. 78f(b)(5).

³³ 15 U.S.C. 78f(c)(3)(B).

³⁴ CBOE's proposed rule change expands its continuing education requirements to associated persons whose activities are limited to the transaction of business on CBOE's floor.

Commission believes the restrictions on registration that bar a TPH from maintaining a registration with CBOE for (1) persons no longer active in the TPH's securities business, (2) persons no longer functioning in the registered capacity, or (3) for avoidance of an examination requirement, are appropriate. These limitations should help ensure that only persons qualified for their category of registration who are engaged in a securities business are able to transact business on CBOE and CBSX.

The Commission notes that CBOE has exempted several categories of associated persons from the new registration requirements. These persons fall outside of CBOE's proposed definition of "engaged in a securities business." CBOE explained that the people excluded would not be considered to be actively engaged in a securities business unless they are registered on the floor of another exchange, in which case they would not have to register with CBOE.³⁵ The Commission understands that CBOE's proposed rule change applies to all associated persons conducting a securities business, on a proprietary or agency basis, on CBOE and CBSX.

The Commission expects that CBOE, consistent with its representation, will have developed and filed with the Commission the appropriate examination for its representatives engaged in a proprietary securities business no later than May 12, 2011. If CBOE fails to do so, the Commission expects CBOE to require all associated persons engaged in the securities business of a TPH to promptly take and pass an appropriate existing examination.

The Commission believes that the requirement that all persons functioning in certain supervisory capacities be registered through WebCRD and be subject to higher qualification standards appropriately reflects the enhanced responsibility of their roles and is consistent with

³⁵ See Notice, p. 6; 75 FR 59775. Such persons must comply with Section 15(b)(8) of the Act.

the Act. The general requirement that TPHs must have a minimum of two principals responsible for oversight of member organization activity on CBOE, who must be registered as such and pass a principal exam, should help CBOE strengthen the regulation of its member firms, and prepare those individuals for their responsibilities. The nature of the firm, however, may dictate that more than two principals are needed to provide appropriate supervision.

The requirement for each TPH organization to have a CCO who must register and pass the Series 14 and a FINOP who must register and pass the Series 27 is appropriate based on the heightened level of accountability inherent in the duty of overseeing compliance by an Exchange member, and in the oversight and preparation of financial reports, and the oversight of those employed in financial and operational capacities at each firm.

The Commission believes CBOE's proposed provision requiring any person whose registration has been revoked by the Exchange as a disciplinary sanction, or whose most recent registration as a principal or representative has been terminated for a period of two or more years immediately preceding the date of receipt by the Exchange of a new application, to pass the qualification examination appropriate to such person's category of registration is appropriate. This requirement should help to ensure that an associated person's qualifications are current.

The Commission also believes CBOE's proposed exceptions from the above-discussed general requirements are appropriate. Any TPH seeking an exception from the two principal minimum must provide evidence that conclusively indicates to the Exchange that only one principal is necessary. The Commission expects this authority to be used sparingly, because such persons oversee the operations of member firms and provide the first line of defense in ensuring that member firms are complying with the rules of an exchange as well as the federal securities laws. In addition, CBOE may waive the qualification examination requirement in

exceptional cases where the applicant has demonstrated that good cause exists. The Commission expects this authority to be used sparingly. Finally, the Commission notes that these exceptions are substantively the same as exceptions provided in similar rules at other SROs.³⁶

The Commission believes that the proposal will enhance CBOE's ability to ensure an effective supervisory structure for those conducting business on CBOE. The requirements apply broadly and are intended to help close a regulatory gap which has resulted in varying registration, qualification, and supervision requirements across markets. The Commission believes that the changes proposed by CBOE to its rules will strengthen the regulatory structure of the Exchange and should enhance the ability of its individual TPHs and TPH organizations to comply with the Exchange's rules as well as with the federal securities laws.

Additionally, the Commission believes that the proposed rule change is consistent with the principles of Section 11A(a)(1)(22) of the Act in that it seeks to assure fair competition among brokers and dealers and among exchange markets. The Commission believes that the proposed rule will promote uniformity of regulation across markets, thus reducing opportunities for regulatory arbitrage. CBOE's proposed rule change helps ensure that all persons conducting a securities business through CBOE are appropriately supervised, as the Commission expects of all SROs.

³⁶ See, e.g., FINRA Rule 1070(d) and NASDAQ Rule 1070(d) regarding the examination waiver.

VI. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁷ that the proposed rule change (SR-CBOE-2010-084), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁸

Florence E. Harmon
Deputy Secretary

³⁷ 15 U.S.C. 78s(b)(2).

³⁸ 17 CFR 200.30-3(a)(12).