

SECURITIES AND EXCHANGE COMMISSION
Release No. 34-71190; File No. SR-CBOE-2013-126

December 26, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to Supervision

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 18, 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 substantially 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

CBOE proposes to adopt a rule requiring each Trading Permit Holder (“TPH”) to establish and maintain a system of supervision and written supervisory procedures. The text of the proposed rule change is available on the Exchange’s website at

<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

¹ 15 U.S.C. 78s(b)(1).

² 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

Effective and comprehensive compliance policies and procedures and supervisory systems are critical to investor protection and market integrity; therefore, the Exchange proposes to adopt Rule 4.24 that would require its TPHs to establish and maintain a system to supervise each of their business activities and the activities of their associated persons.³ As more fully described below, the proposed rule would also require TPHs to: (1) establish, maintain, and enforce written supervisory procedures; (2) inspect every office or location of the TPH at least once every three calendar years; and (3) conduct an annual review and submit to the Exchange on an annual basis a written report on the TPH’s supervision and compliance efforts during the preceding year.

The Exchange does not currently have a comprehensive rule that directly addresses the obligation of every TPH to properly supervise its business and employees. The proposed rule would impose a more definitive supervision requirement on TPHs than is currently contained in the Exchange’s rules, and would cover all business activities of a TPH.⁴

³ Article 1, Section 1.1(f) of the Exchange’s Bylaws defines “Trading Permit Holder” to mean “any individual, corporation, partnership, limited liability company or other entity authorized by the Rules that holds a Trading Permit.” The proposed rule would also apply to CBOE Stock Exchange (“CBSX”) Trading Permit Holders. CBSX is CBOE’s stock trading facility.

⁴ The proposed rule is modeled after similar rules of other self-regulatory organizations (“SROs”), *i.e.*, PHLX Rule 748, NASD Rule 3010, FINRA Rule 3130, NYSE Amex Rule 320, NYSE Rule 342, and NYSE Arca Rule 11.18.

Currently, the only supervision obligations that are expressly codified in CBOE Rules are found in Rule 4.2 - Adherence to Law and Rule 9.8 - Supervision of Accounts. Rule 4.2 reads as follows:

No Trading Permit Holder shall engage in conduct in violation of the Securities Exchange Act of 1934, as amended, rules or regulations thereunder, the Bylaws or the Rules of the Exchange, or the Rules of the Clearing Corporation insofar as they relate to the reporting or clearance of any Exchange transaction, or any written interpretation thereof. Every Trading Permit Holder shall so supervise persons associated with the Trading Permit Holder as to assure compliance therewith.

While it requires a TPH to supervise persons associated with the TPH, Rule 4.2 does not expressly require a system of supervision, or written procedures covering each line of business to be established and maintained. The proposed rule would clearly place responsibility on TPHs to establish and maintain a formal plan of supervision that covers each of its business activities and associated persons.

CBOE Rule 9.8, a component of Chapter 9 - Doing Business with the Public, is applicable only to TPHs conducting non-TPH customer business in options. The proposed rule would mirror many of the requirements in Rule 9.8, in that Rule 9.8 requires TPHs to: (1) establish, maintain, and enforce written supervisory procedures; (2) conduct office inspections; and (3) conduct an annual review and submit to the Exchange an annual written report on the TPH's supervision and compliance efforts during the preceding year. However, the proposed rule would not be limited to supervision of activities related only to TPHs conducting non-TPH customer business in options. Therefore, the proposed rule would provide greater utility for enforcing TPH obligations for other business areas such as proprietary trading.

The Exchange believes the proposed rule would clarify: (1) the responsibility of the TPH for the acts of its associated persons; and (2) the requirement of each TPH to supervise those

associated persons for which it is responsible. Proposed Rule 4.24(a) would generally establish each TPH's responsibility for the supervision and control of the TPH. The proposed rule would also require that each associated person, in addition to each office, location, department, business activity, trading system, and internal surveillance system of a TPH, be under the supervision and control of an appropriately qualified supervisor as described in proposed Rule 4.24(c).⁵

Proposed Rule 4.24(b) would provide for the designation of a general partner or principal executive officer to assume overall authority and responsibility for the supervisory system of the TPH. This designee would then be responsible for: (1) delegating to qualified principals responsibility and authority for supervision and control of each office, location, department, business activity, trading system, and internal surveillance system, as well as providing for appropriate written procedures of supervision and control; and (2) establishing a separate system of follow-up and review to determine that the delegated responsibility and authority is properly exercised.⁶

Proposed Rules 4.24(c) and (d) would provide for the qualifications of supervisors and the standards of supervision, respectively. Under proposed paragraph (c), TPHs would have to make reasonable efforts to determine that those persons with supervisory control, as described in proposed Rules 4.24(a) and (b), are qualified by virtue of experience or training to carry out their assigned responsibilities. This paragraph would also require supervisors to meet the Exchange's qualification requirements for supervisors, including completion of the appropriate examinations.⁷ For example, CBOE Rule 3.6A - Qualification and Registration of Trading

⁵ Proposed Rule 4.24(a) is modeled after PHLX Rule 748(a), NYSE MKT Rule 320(b), NYSE Rule 342(a), NYSE Arca Rule 11.18(b) and NASD Rule 3010(a).

⁶ Proposed Rule 4.24(b) is modeled after PHLX Rule 748(b), NYSE MKT Rule 320(c), NYSE Rule 342(b) and NASD Rule 3010(a).

⁷ Proposed Rule 4.24(c) is modeled after NASD Rule 3010(a)(6) and PHLX Rule 748(c).

Permit Holders and Associated Persons sets forth required examinations for associated persons engaged in the securities business of a TPH. Proposed paragraph (d) would require that any person with supervisory control, as described in proposed Rules 4.24(a) and (b), reasonably discharge his or her duties and obligations in connection with such supervision and control in order to prevent and detect violations of applicable securities laws and regulations and applicable Exchange rules.⁸

Proposed Rule 4.24(e) would require each TPH to establish, maintain, and enforce written supervisory procedures, and a system for applying such procedures, to supervise each of its business activities and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations as well as applicable Exchange rules. The proposed rule would also require that the written supervisory procedures be amended as changes occur to a TPH's personnel or supervisory procedures and within a reasonable time after changes occur in applicable securities laws and regulations and the rules of the Exchange. Additionally, the proposed rule would require TPHs to maintain a record of the name, title, registration status and location of all supervisory personnel required by the proposed rule, the dates for which supervisory designations were or are effective, and the responsibilities of the supervisory personnel as these relate to the types of business the TPH engages in, and applicable securities laws and regulations, including applicable Exchange rules. TPHs would be required to preserve such record for a period of not less than three years, the first two in an easily accessible place. Lastly, the proposed rule would require a copy of the written supervisory procedures to be kept and maintained at each location where supervisory activities are conducted

⁸ Proposed Rule 4.24(d) is modeled after PHLX Rule 748(d), NYSE MKT Rule 320(b) and NYSE Rule 342(a).

on behalf of the TPH.⁹

Proposed Rule 4.24(f) would require that each TPH perform inspections of every office or location of the TPH at least once every three calendar years. An inspection could not be conducted by any person within that office or location who has supervisory responsibilities or by any individual who is directly or indirectly supervised by such person(s). This provision is intended to help ensure that all activity of an office or location is monitored for compliance with applicable regulatory requirements by persons who do not have a personal interest in such activity. The proposed rule would require the examination schedule and an explanation of the factors considered in determining the frequency of the examinations in the cycle to be set forth in the TPH's written supervisory procedures. When establishing the inspection cycle, the TPH would be required to consider the nature and complexity of the securities activities for which the office or location is responsible, the volume of business done, and the number of associated persons at each office or location. For each inspection, the TPH would be required to retain a written record of the dates upon which each inspection is conducted, the participants involved, and the results thereof.¹⁰

As noted above, effective and comprehensive compliance policies and procedures and supervisory systems are key to investor protection and market integrity. Therefore, it is essential that TPHs put adequate emphasis on the importance of compliance throughout the firm. To promote regular discussion and review of its supervisory system, proposed Rule 4.24(g) would require each TPH to conduct an annual review and submit to the Exchange on an annual basis a written report on the TPH's supervisory system.

⁹ Proposed Rule 4.24(e) is modeled after PHLX Rule 748(h) and NASD Rule 3010(b)(1), (3) and (4).

¹⁰ Proposed Rule 4.24(f) is modeled after PHLX Rule 748(g) and NASD Rules 3010(c)(1)(B) and (c)(3).

Paragraph (g)(1) of proposed Rule 4.24 would require that each TPH conduct annual meetings or interviews with all associated persons to discuss compliance matters relevant to their activities. The TPH would be required to maintain a written record of the dates the meetings or interviews were held, who was present at each meeting or interview, and the results thereof.¹¹

Proposed Rule 4.24(g)(2) would require TPHs to prepare a written report on the firm's supervision and compliance efforts during the preceding year and on the adequacy of the firm's ongoing compliance processes and procedures. TPHs would be required to submit such report to the Exchange by April 1 of each year. The proposed Rule would require that the report include four elements: (1) a tabulation of customer complaints (including arbitrations and civil actions) and internal investigations, if any; (2) identification and analysis of significant compliance problems, plans for future systems or procedures to prevent and detect violations and problems, and an assessment of the preceding year's efforts of this nature; (3) discussion of the preceding year's compliance efforts, new procedures, educational programs, etc. in the areas of antifraud and trading practices, books and records, finance and operations, supervision, internal controls, and anti-money laundering; and (4) a certification signed by the TPH's Chief Executive Officer ("CEO") or equivalent officer.¹²

The certification signed by the TPH's CEO (or equivalent officer) would be required to include four components, the last three of which would be intended to foster regular and significant interaction between senior management and the Chief Compliance Officer ("CCO") regarding the TPH's comprehensive compliance program:

The first component relates to requirements found in paragraph (e) of the proposed rule.¹³

¹¹ Proposed Rule 4.24(g)(1) is modeled after PHLX Rule 748(e)(1).

¹² Proposed Rule 4.24(g)(2) is modeled after CBOE Rule 9.8(g)(1) – (5).

¹³ See Proposed Rule 4.24(g)(2)(D)(i).

Specifically, the CEO (or equivalent officer) would be required to certify that the TPH has in place processes to: (1) establish and maintain policies and procedures reasonably designed to achieve compliance with applicable Exchange rules and federal securities laws and regulations; (2) modify such policies and procedures as business, regulatory and legislative changes and events dictate; and (3) test the effectiveness of such policies and procedures on a periodic basis.¹⁴

The second component would require the CEO (or equivalent officer) to certify that he or she conducted one or more meetings with the firm's CCO during the preceding 12 months in which they discussed and reviewed the matters described in the certification, including the TPH's prior compliance efforts.¹⁵ The CEO (or equivalent officer) and CCO would also be required to identify and address any significant compliance problems or plans for emerging business areas.¹⁶

The third component of the certification would require the CEO (or equivalent officer) to certify that he or she reviewed a report evidencing the processes covered in the first component of the certification.¹⁷ This report would also be reviewed by the CCO and such other officers as the TPH deems necessary in order for the CEO to make the required certification. Further, the CEO would be required to certify that the report was submitted to the TPH's board of directors or audit committee by April 1st of each year. If a TPH does not utilize these types of governing bodies in the conduct of its business, the TPH would be required to have the report reviewed by any governing body or committee that serves a similar function in lieu of a board of directors or

¹⁴ Proposed Rule 4.24(g)(2)(D)(i) is modeled after FINRA Rule 3130(c)(1) and CBOE Rule 9.8(g)(5)(i).

¹⁵ See Proposed Rule 4.24(g)(2)(D)(ii).

¹⁶ Proposed Rule 4.24(g)(2)(D)(ii) is modeled after FINRA Rule 3130(c)(2) and CBOE Rule 9.8(g)(5)(ii).

¹⁷ See Proposed Rule 4.24(g)(2)(D)(iii).

audit committee.¹⁸

The fourth component of the certification¹⁹ would require the CEO (or equivalent officer) to certify that he or she consulted with the CCO and other officers referenced in proposed Rule 4.24(g)(2)(D)(iii) and other such employees, outside consultants, lawyers and accountants, to the extent she or she deems appropriate, in order to attest to the statements made in the certification.²⁰

Finally, proposed paragraph (g)(3) would deem any TPH to have met the requirements of proposed Rules 4.24(g)(1) and (2) if the TPH specifically includes its options compliance program within an annual compliance review and written report that complies with substantially similar requirements of the Financial Industry Regulatory Authority, Inc. or any other SRO.²¹ In that case, the TPH would still be required to submit a copy of such written report to the Exchange by April 1 of each year.

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.²² Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5) of the Act,²³ which requires that the rules of an exchange be designed to, among other things, prevent fraudulent and manipulative acts and practices, to

¹⁸ Proposed Rule 4.24(g)(2)(D)(iii) is modeled after FINRA Rule 3130(c)(3) and CBOE Rule 9.8(g)(5)(iii).

¹⁹ See Proposed Rule 4.24(g)(2)(D)(iv).

²⁰ Proposed Rule 4.24(g)(2)(D)(iv) is modeled after FINRA Rule 3130(c)(4) and CBOE Rule 9.8(g)(5)(iv).

²¹ Proposed Rule 4.24(g)(3) is modeled after CBOE Rule 9.8(g)(5).

²² 15 U.S.C. 78f(b).

²³ 15 U.S.C. 78f(b)(5).

promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

Compliance with applicable Exchange rules and federal securities laws is the bedrock of investor protection and market integrity. Therefore it is critical that TPHs employ comprehensive and effective compliance policies and procedures. The Exchange believes the proposed rule change would help promote just and equitable principles of trade and protect investors and the public interest by upgrading and strengthening the Exchange's rules pertaining to supervisory obligations of its TPHs.

TPHs are on the front line of defense against fraudulent and manipulative acts and practices. TPHs are in the unique position to identify potential rule violations or other inappropriate activity and correct it before intervention by the exchanges or the Commission. The Exchange believes a comprehensive supervision rule such as proposed Rule 4.24 should help to prevent fraudulent and manipulative acts and practices consistent with Section 6(b)(5) of the Act.

The Exchange believes that the proposed rule change should strengthen the Exchange's ability to examine TPHs for compliance with supervisory requirements by compelling that written supervisory procedures be maintained. Written supervisory procedures should provide TPHs and their supervisory personnel with a clear understanding of their supervisory responsibilities thus helping to ensure that those responsibilities are carried out effectively and efficiently. The Exchange also believes the proposal to require inspections of offices or other locations of TPHs would help strengthen the ability of TPHs to carry out their compliance and surveillance functions. By requiring written supervisory procedures and inspections that are reasonably designed to prevent and detect violations of applicable securities laws and

regulations, as well as Exchange rules, the proposed rule would help to ensure that TPHs have the necessary processes in place to identify potential rule violations or inappropriate activity.

Furthermore, the Exchange believes the proposed requirements for an annual certification and written report would enhance focus on a TPH's compliance and supervision systems by promoting a dialogue throughout the TPH of its compliance efforts and procedures, thereby decreasing the likelihood of fraudulent and manipulative acts and practices and increasing investor protection.

Lastly, the Exchange believes the proposed rule change furthers the objectives of Section 6(b)(1)²⁴ of the Act, which provides that the Exchange must be organized and have the capacity to be able to carry out the purposes of the Act and to enforce compliance by the Exchange's TPHs and persons associated with its TPHs with the Act, the rules and regulations thereunder, and the rules of the Exchange. Requiring comprehensive supervision by TPHs and their associated persons of their activities should promote the Exchange's ability to enforce compliance by TPHs and their associated persons with the Act and the regulations thereunder.

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 believes the proposed rule change would upgrade and strengthen the Exchange's rules pertaining to supervisory obligations of its TPHs. As noted below, the proposed rule change is based on similar rules of other SROs.

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.

²⁴ 15 U.S.C. 78(f)(b)(1).

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
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2013-126 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-2013-126. 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 the 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-2013-126 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.²⁵

Lynn M. Powalski
Deputy Secretary

²⁵ 17 CFR 200.30-3(a)(12).