

SECURITIES AND EXCHANGE COMMISSION  
Release No. 34-71644; File No. SR-CBOE-2013-126

March 4, 2014

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change Relating to Supervision

I. Introduction

On December 18, 2013, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to require each Trading Permit Holder (“TPH”)<sup>3</sup> to establish and maintain a system of supervision and written supervisory procedures.

The proposed rule change was published for comment in the Federal Register on January 2, 2014.<sup>4</sup> The Commission received no comments on the proposal. The text of the proposed rule change is available at the Exchange’s Office of the Secretary, on the Exchange’s website at <http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>, and at the Commission’s Public Reference Room.

This order approves the proposed rule change.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 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.

<sup>4</sup> See Exchange Act Release No. 71190 (Nov. 14, 2013), 79 FR 169 (Jan. 2, 2014).

## II. Description of the Proposal

The Exchange believes that it does not currently have a comprehensive rule that directly addresses the obligation of every TPH to properly supervise its business and employees. The only supervision obligations that are expressly codified in CBOE's Rules are in Rule 4.2 (Adherence to Law) and Rule 9.8 (Supervision of Accounts). While the former requires a TPH to supervise persons associated with the TPH, it does not expressly require the establishment and maintenance of a system of supervision or written procedures covering each line of business. The latter, a component of Chapter 9 of the CBOE Rulebook (Doing Business with the Public), does provide explicit supervisory obligations, however, it is applicable only to TPHs conducting non-TPH customer business in options.

CBOE proposes to adopt CBOE Rule 4.24, which would require every TPH to establish and maintain a system of supervision and written supervisory procedures for each of their business activities and the activities of their associated persons. In particular, the proposed rule would 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 proposed rule would mirror many of the requirements in CBOE Rule 9.8, such as requiring 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. The proposed rule would not, however, be limited to supervision of activities related only to TPHs conducting non-TPH customer business in options.

CBOE believes that 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.<sup>5</sup> In particular, the proposed rule would clearly place responsibility on TPHs to establish and maintain a formal plan of supervision that covers each of their business activities and associated persons. Consequently, 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. In addition, CBOE believes that the proposed rule would provide greater utility for enforcing TPH obligations for all its business areas such as proprietary trading.

### **III. Discussion and Commission Findings**

After careful review of the proposal, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange.<sup>6</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act, 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.<sup>7</sup>

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<sup>5</sup> The Exchange modeled its proposed rule after rules of other self-regulatory organizations, e.g., PHLX Rule 748, NASD Rule 3010, FINRA Rule 3130, NYSE Amex Rule 320, NYSE Rule 342, and NYSE Arca Options Rule 11.18.

<sup>6</sup> In approving the proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

The Commission “has long emphasized that the responsibility of broker-dealers to supervise their employees is a critical component of the federal regulatory scheme.”<sup>8</sup> Effective and comprehensive supervisory policies and procedures, among other things, are critical to a firm’s ability to surveil for misconduct.

Accordingly, the Commission believes the proposed rule change would help TPHs prevent fraudulent and manipulative acts and practices and improve investor protection by requiring TPHs to clearly delineate their supervisory obligations.

In particular, the Commission believes that compelling every TPH to establish and maintain written supervisory procedures regarding each of their business activities and associated persons would provide TPHs and their supervisory personnel with a clearer understanding of their supervisory responsibilities to help them carry out those responsibilities. In addition, the Commission believes that requiring TPHs to inspect all of their offices or locations at least once every three calendar years would strengthen TPHs’ ability to carry out their compliance and surveillance functions. Similarly, the Commission believes that requiring TPHs to 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 would help foster a culture of compliance within each TPH by promoting a dialogue throughout the TPH of its compliance efforts and procedures.

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. Consequently, the

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<sup>8</sup> Commission, Division of Market Regulation (now known as Division of Trading and Markets), Staff Legal Bulletin No. 17: Remote Office Supervision (Mar. 19, 2004).

Commission believes that the Exchange's proposal would foster an environment within each TPH that is more likely to help decrease the likelihood of fraudulent and manipulative acts and practices and increase investor protection.

Accordingly, the Commission believes that the proposed rule change is consistent with the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-CBOE-2013-126) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).