

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72668; File No. SR-CBOE-2014-048)

July 24, 2014

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change Relating to the Give Up of a Clearing Trading Permit Holder

I. Introduction

On May 23, 2014, Chicago Board Options Exchange, Incorporated (“CBOE” or the “Exchange”) 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 relating to the “give up” process, the process by which a Trading Permit Holder (“TPH”) “gives up” or selects and indicates the Clearing Trading Permit Holder (“CTPH”) responsible for the clearance of an Exchange transaction. The proposed rule change was published for comment in the Federal Register on June 11, 2014.³ The Commission received no comment letters on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

A. Background

CBOE proposes to amend Rules 6.21 and 6.50 that govern the give up of a CTPH by a TPH on Exchange transactions. In order to enter transactions on the Exchange, a TPH must either be a CTPH or have a CTPH agree to accept financial responsibility for the TPH’s transactions. Current CBOE Rule 6.21 provides that for each transaction in which a TPH participates, the TPH must give up the name of the CTPH (the “give up”) through which the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 72325 (June 5, 2014), 79 FR 33614 (June 11, 2014) (“Notice”).

transaction will be cleared. CBOE Rule 6.50 further provides that every CTPH will be responsible for the clearance of Exchange transactions of each TPH that gives up the CTPH's name pursuant to a letter of authorization, letter of guarantee, or other authorization given by the CTPH to the executing TPH.⁴ CBOE proposes to amend Rules 6.21 and 6.50 to address the give up process, including procedures governing that process, in greater detail.

B. Designated Give Ups and Guarantors

CBOE proposes to amend Rule 6.21 to provide that a TPH that is not a market maker may only give up (i) a CTPH that has previously been identified and processed by the Exchange as a "designated give up" for that TPH, or (ii) a guarantor of the TPH. The Exchange proposes to introduce and define the term "designated give up" as a CTPH that a TPH (other than a market maker) identifies in advance to the Exchange, in writing, as a CTPH that the TPH would like the ability to give up on its trades.⁵ A TPH will be required to identify to CBOE any designated give ups in advance of giving up any CTPH that is not a guarantor for the TPH. The Exchange has proposed a standardized form ("Notification Form") that a TPH will be required to submit to the Exchange's Registration Services Department in order to identify its designated give ups. If a TPH no longer wants the ability to give up a particular designated give up, the TPH must notify the Exchange in writing by submitting a Notification Form. CBOE proposes to allow a TPH to submit a Notification Form identifying any CTPH as a designated give up and does not propose any minimum or maximum number of designated give ups that a TPH may identify.⁶

The Exchange will notify a CTPH, in writing and as soon as practicable, of each TPH that has identified the CTPH as one of its designated give ups. In its proposal, CBOE noted that

⁴ See Notice, supra note 3, at 33614.

⁵ See proposed Rule 6.21(b)(i).

⁶ See Notice, supra note 3, at 33614.

it will disregard any instructions from a CTPH not to permit a particular TPH to designate the CTPH as a designated give up and will not perform any subjective evaluation of a TPH's list of proposed designated give ups.⁷ Rather, the Exchange will only ensure that the CTPHs that a TPH identifies on the Notification Form as designated give ups are current CBOE CTPHs and will review the Notification Form for completeness and accuracy.⁸

CBOE proposes to define the term “guarantor” for purposes of proposed Rule 6.21 as a CTPH that has issued a letter of guarantee or a letter of authorization for the executing TPH under the rules of the Exchange that are in effect at the time of the execution of the trade.⁹ An executing TPH may give up its guarantor without identifying the guarantor as a designated give up (i.e., the guarantor accepts clearing responsibility for all trades of its guarantee TPH pursuant to its role as the default CTPH for that TPH, unless the TPH indicates an alternate CTPH to be the designed give up on a particular trade), and the TPH therefore would not need to submit a Notification Form to the Exchange before indicating its guarantor as a designated give up. Because CBOE Rule 8.5 requires that a letter of guarantee be issued and filed with the Exchange by each CTPH through which a market maker desires to clear transactions, the Exchange proposes that a TPH that is a market maker only be enabled to give up a guarantor of the market maker.¹⁰

⁷ See id. The ability of a CTPH to reject a trade on which it was indicated as the designated give up is discussed below.

⁸ See id.

⁹ See proposed Rule 6.21(b)(ii).

¹⁰ See Rule 8.5; see also Notice, supra note 3, at 33614.

In its proposal, CBOE states that it will configure its trading systems to only accept orders that identify a designated give up or a guarantor for the TPH.¹¹ The Exchange further states that this configuration is intended to prevent a TPH from erroneously giving up the name of a CTPH that it had no intention of using as a designated give up.¹²

C. Non-Acceptance of a Trade

CBOE proposes to allow a designated give up or a guarantor, in certain circumstances, to not accept a trade for which its name was given up. A designated give up may determine not to accept a trade if it believes in good faith that it has a valid reason not to accept the trade, in which case it may reject the trade by following the procedures set forth in proposed Rule 6.21, which are described below.¹³ Where a designated give up determines not to accept a trade for which its name was given up, the executing TPH's guarantor or another CTPH that has agreed to be the give up on the trade will become the give up. With respect to guarantors, CBOE proposes to permit a guarantor to not accept a non-market maker trade for which its name was given up only if another CTPH agrees to be the give up on the trade and has notified the Exchange and executing TPH in writing of its intent to accept the trade. Only a designated give up or guarantor whose name was initially given up on a trade may determine not to accept a trade. Therefore, a

¹¹ See Notice, supra note 3, at 33614-15. Conversely, CBOE states in its proposal that its systems will reject any order that designates a give up that is not at the time a designated give up or is otherwise the guarantor for the TPH. See id.

¹² See id. The Exchange states that it will notify a TPH in writing when one of its designated give ups becomes effective in the Exchange's trading systems following the submission by the TPH of the required Notification Form. See id.

¹³ According to CBOE, examples of valid reasons include that the designated give up does not have a customer for the particular trade or that another CTPH has agreed to be the give up on the trade and has notified the Exchange and executing TPH of its intent to accept the trade. See Notice, supra note 3, at 33615.

CTPH or guarantor that becomes the give up on a rejected trade may not subsequently reject the trade themselves.¹⁴

D. Procedures to Reject on Trade Date

A designated give up that rejects a trade on the trade date must notify, in writing, the executing TPH or its designated agent as soon as possible and attempt to resolve the disputed give up.¹⁵ If no resolution is reached and the designated give up still intends to reject the trade, then the designated give up will be required to complete and submit to the Exchange a standardized form (“Give Up Change Form”) in which it is required to identify the new give up. As long as the Exchange is able to process the form before the trade input cutoff time established by the Clearing Corporation (or fifteen minutes thereafter if the Exchange receives and is able to process a request to extend its time of final trade submission to the Clearing Corporation) (“Trade Date Cutoff Time”), the Exchange will allow the designated give up to change the give up on the trade to either (i) another CTPH that has agreed to accept the trade, or (ii) the executing TPH’s guarantor.¹⁶ If another CTPH has agreed to step in as the give up, the new CTPH must complete and submit to the Exchange another standardized form (“CBOE Give-Up Change Form For Accepting Clearing Trading Permit Holders”) reflecting its intent to accept the trade. A designated give up may change the give up on a trade to a guarantor for the executing TPH so long as the designated give up has first notified the guarantor in writing.¹⁷ As discussed above, where a designated give up has rejected a trade, neither a CTPH that has agreed to become the

¹⁴ See id.

¹⁵ See proposed Rule 6.21(f)(i).

¹⁶ See Notice, supra note 3, at 33615.

¹⁷ See proposed Rule 6.21(f)(ii). In such case, the guarantor does not need to notify the Exchange of its intent to accept the trade or submit any form to the Exchange. See Notice, supra note 3, at 33615.

give up on a trade nor a guarantor that becomes the give up may subsequently reject the trade. This prohibition prevents a trade from being repeatedly reassigned from one CTPH to another.¹⁸

A guarantor may reject a non-market maker trade for which its name was initially given up only if another CTPH agrees to be the give up and the new CTPH has first notified in writing both the Exchange and the executing TPH of its willingness to accept the trade.¹⁹ If a guarantor rejects a trade on the trade date, it also is required to follow the same procedures that a designated give up uses to change the give up, which includes submitting the Give Up Change Form to the Exchange.

The designated give up or guarantor that changes the give up must notify the Exchange, the parties to the trade, and the new CTPH in writing immediately after making the change.²⁰

E. Procedures to Reject on T+1

Recognizing that some firms may take longer to reconcile their trades, CBOE also has proposed to establish procedures for a designated give up or guarantor of a TPH that is not a market maker to reject a trade and change the give up by entering trade records into the Exchange's trading system on the day after the trade date ("T+1") in order to effect a transfer of the trade to the new give up.²¹ The ability of a designated give up or guarantor to make such changes ends at 12:00 p.m. CST ("T+1 Cutoff Time").²² This process is not applicable to, and

¹⁸ See Notice, supra note 3, at 33615.

¹⁹ See proposed Rule 6.21(e)(ii).

²⁰ See id.

²¹ The procedures for rejecting a trade and change the give up on T+1 are substantially similar to the procedures for making such changes on the trade date. See Notice, supra note 3, at 33615-16; see also proposed Rule 6.21(f)(ii-iii).

²² See Notice, supra note 3, at 33616.

no changes to the give up may be made for, transactions in expiring options series that take place on the last trading day prior to its expiration.

F. Other Give Up Changes

CBOE's proposal also sets forth three situations in which a give up may be changed without Exchange involvement (other than after-the-fact notice to the Exchange).²³ First, if the executing TPH has the ability through an Exchange system to do so, the TPH may change the give up on the trade to another designated give up or to the TPH's guarantor if done before the Trade Date Cutoff Time. In addition, if a designated give up has the ability through an Exchange system to do so, it may change the give up on a trade to another CTPH affiliated with the designated give up or to a CTPH that is a back office agent for the designated give up if done before the Trade Cutoff Time. Finally, if both a designated give up (or guarantor) and an accepting CTPH have the ability through an Exchange system to do so, they may each enter trade records into the Exchange's systems on T+1 (if done before the T+1 Cutoff Time) that would effect a transfer of the trade in a non-expired options series from that designated give up (or guarantor) to that new accepting CTPH. A designated give up (or guarantor) must notify the Exchange and all parties to the trade, in writing, of any such change.

G. Financial Responsibility for Trades

In its proposal, CBOE notes that a CTPH is financially responsible for all trades for which it is the give up as of the applicable cutoff time (Trade Date Cutoff Time or T+1 Cutoff Time). However, CBOE notes in its proposal that its proposed rule changes do not preclude a different party from being responsible for the trade pursuant to the rules of the Clearing

²³ See proposed Rule 6.21(g).

Corporation, any agreement between the applicable parties, or other applicable rules, regulations, arbitration, court proceedings, or otherwise.²⁴

Finally, CBOE proposes to eliminate language in Rule 6.50 that addresses financial responsibility of transactions clearing through CTPHs because financial responsibility is now addressed in new paragraph (h) to Rule 6.21.²⁵

III. Discussion and Commission Findings

After careful consideration 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 applicable to a national securities exchange,²⁶ and, in particular, the requirements of Section 6 of the Act.²⁷ Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,²⁸ which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.

In particular, the Commission believes that by providing more detailed requirements relating to the give up process, the proposal is designed to bring greater operational certainty and efficiency to that process. For example, requiring TPHs and CTPHs to use standardized forms to

²⁴ See Notice, supra note 3, at 33617.

²⁵ See id.

²⁶ 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).

²⁷ 15 U.S.C. 78f.

²⁸ 15 U.S.C. 78f(b)(5).

designate give ups, reject a trade and change the give up on a trade, and accept a trade as a new give up should enhance CBOE's ability to efficiently monitor and enforce compliance with its rules relating to the give up process. Use of standardized forms also may make it easier for TPHs and CTPHs to comply with the proposed rules, and should benefit all members by providing a written confirmation to evidence any changes in clearing responsibility for a particular trade. In addition, the process specified in the proposed rule should provide greater transparency and certainty to members about the expectations and requirements attendant to the give up process, and should help facilitate a common process among exchange members in the event that a change to a designated give up becomes necessary.

The Commission believes that the proposal addresses the role of different parties involved in the give up process in a balanced manner and is designed to provide a fair and reasonable methodology for the give up process. For example, the proposed rule change allows executing TPHs to designate any current CBOE CTPH as a designated give up while also obligating the Exchange to notify CTPHs of each TPH that has identified the CTPH as a designated give up. Moreover, the proposal creates procedures for a CTPH to reject a trade where the CTPH has a good faith belief that it has a valid reason not to accept the trade. Although a CTPH with a valid reason may reject a trade, the proposal ensures that there is finality to this process by prohibiting a CTPH that agrees to become the give up on a trade (or a guarantor that is assigned the trade) from subsequently rejecting the trade. In this manner, the proposed rule change is designed to ensure that there will always be a CPTH that will be financially responsible for a trade, which should promote greater operational certainty and facilitate cooperation and coordination with persons engaged in clearing transactions.

Accordingly, the Commission finds that the Exchange's proposal is consistent with the Act, including Section 6(b)(5) thereof, in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market, and in general, protect investors and the public interest.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁹ that the proposed rule change (SR-CBOE-2014-048), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁰

Kevin M. O'Neill
Deputy Secretary

²⁹ 15 U.S.C. 78s(b)(2).

³⁰ 17 CFR 200.30-3(a)(12).