

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68100; File No. SR-CFE-2012-001)

October 24, 2012

Self-Regulatory Organizations; CBOE Futures Exchange, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Adopt and Amend Certain Rules that Are Applicable to Security Futures

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on October 17, 2012, CBOE Futures Exchange, LLC (“CFE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change described in Items I, II, and III below, which Items have been prepared by CFE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. CFE also has filed this proposed rule change with the Commodity Futures Trading Commission (“CFTC”). CFE filed a written certification with the CFTC under Section 5c(c) of the Commodity Exchange Act (“CEA”)² on October 2, 2012 for effectiveness on October 17, 2012.

I. Self-Regulatory Organization’s Description of the Proposed Rule Change

The Exchange proposes to adopt and amend certain rules that are applicable to security futures traded on CFE. The only security futures currently traded on CFE are traded under Chapter 16 of CFE's Rulebook which is applicable to Individual Stock Based and Exchange-Traded Fund Based Volatility Index (“Volatility Index”) security futures. The rule amendments included as part of this rule change relate generally to improper trading practices, recordkeeping, reporting, and coordinated trading halts. The text of the proposed rule change is attached as Exhibit 4.

¹ 15 U.S.C. 78s(b)(7).

² 7 U.S.C. 7a-2(c).

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, CFE 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 Item IV below. CFE 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

The purpose of the proposed CFE rule amendments included as part of this rule change is to amend CFE rules consistent with the rules, acceptable practices, and guidance adopted by the Commodity Futures Trading Commission ("CFTC") under the caption Core Principles and Other Requirements for Designated Contract Markets ("DCMs") and published in the Federal Register at 77 FR 36611 (June 19, 2012) ("CFTC Rulemaking"). The rule amendments included as part of this rule change are to apply to all products traded on CFE, including both non-security futures and security futures. CFE is making these rule amendments in conjunction with other rule amendments being made by CFE consistent with the CFTC Rulemaking that are not required to be submitted to the Commission pursuant to Section 19(b)(7) of the Act³ and thus are not included as part of this rule change.

Improper Trading Practices

CFE is proposing to add to its Rules CFE Rule 616 relating to wash trades, CFE Rule 617 relating to money passes, CFE Rule 618 relating to accommodation trading, and CFE Rule 619

³ 15 U.S.C. 78s(b)(7).

relating to front-running. In addition, CFE is proposing to add CFE Rule 620 to its Rulebook in order to specifically prohibit the disruptive practices enumerated in Section 4c(a)(5) of the Commodity Exchange Act,⁴ which were added to the Act by Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.⁵

These abusive trading practices are already prohibited by CFE Rules. For example, CFE Rule 604 prohibits CFE Trading Privilege Holders and their Related Parties from engaging in conduct in violation of Applicable Law (which includes, among other things, the CEA,⁶ CFTC regulations, and to the extent applicable, the Act⁷ as well as Regulations under the Act), and CFE Rule 608 prohibits conduct inconsistent with just and equitable principles of trade.

Although these practices are already prohibited by other CFE rules, each of these practices as they relate to futures trading is now also proposed to be specifically addressed in CFE's Rulebook through the addition of the above rules. The addition of these rules is consistent with CFTC Regulation 38.152⁸ which provides that DCMs must specifically prohibit certain trading practices and any other manipulative or disruptive practices prohibited by the CEA.⁹

CFE Rule 616 is proposed to provide that no Trading Privilege Holder nor any of its Related Parties shall place or accept buy and sell orders in the same CFE Contract and expiration month, and, for a put or call option, the same strike price, where the Trading Privilege Holder or Related Party knows or reasonably should know that the purpose of the orders is to avoid taking

⁴ 7 U.S.C. 6c(a)(5).

⁵ Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

⁶ 7 U.S.C. 1 et seq.

⁷ 15 U.S.C. 78a et seq.

⁸ 17 CFR 38.152.

⁹ 7 U.S.C. 1 et seq.

a bona fide market position exposed to market risk (transactions commonly known or referred to as wash trades). Buy and sell orders for different accounts with common beneficial ownership that are entered with the intent to negate market risk or price competition would also be deemed to violate the prohibition on wash trades. Additionally, Rule 616 is proposed to provide that no Trading Privilege Holder nor any of its Related Parties shall knowingly execute or accommodate the execution of such orders by direct or indirect means.

CFE Rule 617 regarding money passes is proposed to provide that no Trading Privilege Holder nor any of its Related Parties shall prearrange the execution of transactions on the Exchange for the purpose of passing money between accounts. Rule 617 would also require that all transactions executed on the Exchange must be made in good faith for the purpose of executing bona fide transactions and that prearranged trades intended to effectuate a transfer of funds from one account to another are prohibited.

CFE Rule 618 regarding accommodation trading is proposed to provide that no Trading Privilege Holder nor any of its Related Parties shall enter into non-competitive transactions on the Exchange for the purpose of assisting another Person to engage in transactions that are in violation of the Rules of the Exchange or Applicable Law.

CFE Rule 619 regarding front running is proposed to provide that no Trading Privilege Holder nor any of its Related Parties shall take a position in a CFE Contract based upon non-public information regarding an impending transaction by another Person in the same or a related Contract, except as expressly permitted by other enumerated Exchange Rules or in accordance with any policies or procedures for pre-execution discussions from time to time adopted by the Exchange.

CFE Rule 620 regarding disruptive practices is proposed to provide that no Trading

Privilege Holder nor any of its Related Parties shall engage in any trading, practice, or conduct on the Exchange or subject to the Rules of the Exchange that (i) violates bids or offers; (ii) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (iii) is, is of the character of, or is commonly known in the trade as “spoofing” (bidding or offering with the intent to cancel the bid or offer before execution).

Rule 608, which already prohibits any act detrimental to the Exchange and conduct inconsistent with just and equitable principles of trade, is proposed to be revised to also prohibit abusive practices, including without limitation, fraudulent, noncompetitive, or unfair actions. The addition of this language is consistent with CFTC Regulation 38.651¹⁰ which provides that a DCM must have and enforce rules that are designed to promote fair and equitable trading and to protect the market and market participants from abusive practices, including fraudulent, noncompetitive, or unfair actions, committed by any party.

Rule 608 and Rule 604 are also proposed to be amended to eliminate redundancy between the two rules. Rule 604 relates to adherence to law and is proposed to be amended to also prohibit Trading Privilege Holders and their Related Parties from engaging in conduct in violation of an agreement with the Exchange. This provision is currently in Rule 608, and CFE believes that a more logical place for it is in Rule 604. Therefore, the provision is proposed to be moved to Rule 604. Rule 608 is also proposed to be amended to delete a prohibition on violating Exchange and Clearing Corporation rules since this prohibition already exists in Rule 604.

Recordkeeping

CFE is proposing to further specify certain recordkeeping requirements in CFE's rules.

New CFE Rule 414(f) is proposed to be added to Rule 414 relating to Exchange of

¹⁰ 17 CFR 38.651.

Contract for Related Position (“ECRP”) transactions and CFE Rule 415(e) relating to Block Trades is proposed to be amended to require every Trading Privilege Holder handling, executing, clearing, or carrying ECRP transactions, Block Trades, or ECRP or Block Trade positions to mark as such by appropriate symbol or designation all of these transactions or positions and all orders, records, and memoranda pertaining thereto. This change incorporates a requirement that already exists under CFTC Regulation 1.38(b)¹¹ and generally under CFE Rule 604, which requires adherence to CFTC regulations, and will now be specifically stated in CFE's rules. Additionally, current Rule 414(f) is proposed to be re-numbered as Rule 414(g) and to be amended to make clear that each Trading Privilege Holder involved in an ECRP transaction must maintain or be able to obtain from its Customer documentation relating to the Related Position portion of the ECRP transaction, including those documents customarily generated in accordance with Related Position market practices which demonstrate the existence and nature of the Related Position portion of the transaction.

CFE Rule 418(d) is proposed to be amended to provide that CFE will submit to the CFTC in accordance with CFTC Regulation 40.6¹² information on all regulatory actions carried out by CFE pursuant to Rule 418, which authorizes CFE to take various emergency actions.

CFE Rule 501(a) is proposed to be amended to provide that the books and records which each Trading Privilege Holder and CFE Clearing Member must maintain shall include, without limitation, records of the activity, positions, and transactions of each Trading Privilege Holder and Clearing Member in the underlying commodity or reference market and related derivatives markets in relation to a CFE Contract. Additionally, Rule 501(c) is proposed to be revised to provide that if a CFE Contract is settled by reference to the price of a contract or commodity

¹¹ 17 CFR 1.38(b).

¹² 17 CFR 40.6.

traded in another venue, including a price or index derived from prices on another designated contract market, Trading Privilege Holders shall make available to the Exchange upon request in a form and manner prescribed by the Exchange and within the time frame designated by the Exchange information and their books and records regarding their activities in the reference market. The addition of these requirements is consistent with the requirements of CFTC Regulation 38.253(b).¹³

CFE is proposing to specifically incorporate into its Rulebook certain CFTC Regulations relating to recordkeeping and to provide that a violation of any of those regulations shall be deemed a violation of a specific CFE Rule. These requirements are proposed to be incorporated into an Appendix to Chapter 5 of CFE's Rulebook, and CFE Rule 518 is proposed to be added as the first rule in this Appendix. Rule 518 is proposed to provide that without limiting the generality and applicability of the prior rules in Chapter 5, any other CFE rules, and Applicable Law, Trading Privilege Holders shall comply with the CFTC regulations relating to minimum financial requirements, financial reporting requirements, and protection of customer funds that are set forth in the Appendix to Chapter 5 to the extent that Trading Privilege Holders are subject to those CFTC regulations. Rule 518 is also proposed to provide that to the extent that any of the CFTC regulations set forth in the Appendix to Chapter 5 are amended from time to time by the CFTC, Trading Privilege Holders are required to comply with the CFTC regulations as amended, to the extent applicable, regardless of whether CFE has yet amended the Appendix to Chapter 5 to incorporate the amendments.

The recordkeeping requirements proposed to be included in the Appendix to Chapter 5 already exist generally under CFE Rule 604, which requires adherence to CFTC regulations, and

¹³ 17 CFR 38.253(b).

will now be specifically incorporated into CFE's rules consistent with the provisions of CFTC Regulation 38.603.¹⁴ In particular, CFE is proposing to add as part of the Appendix to Chapter 5 CFE Rule 522 which incorporates into CFE's Rulebook CFTC Regulation 1.18 (Records for and relating to Financial Reporting and Monthly Computation by Futures Commission Merchants and Introducing Brokers),¹⁵ CFE Rule 528 which incorporates in CFE's Rulebook CFTC Regulation 1.25 (Investment of Customer Funds),¹⁶ CFE Rule 530 which incorporates into CFE's Rulebook CFTC Regulation 1.27 (Record of Investments),¹⁷ CFE Rule 534 which incorporates into CFE's Rulebook CFTC Regulation 1.31 (Books and Records; Keeping and Inspection),¹⁸ CFE Rule 535 which incorporates into CFE's Rulebook CFTC Regulation 1.32 (Segregated Account; Daily Computation and Record),¹⁹ and CFE Rule 536 which incorporates into CFE's Rulebook CFTC Regulation 1.36 (Record of Securities and Property Received from Customers and Options Customers).²⁰

Reporting

Rule 501(a) is proposed to be revised to make clear that books and records required to be prepared and kept current under Rule 501(a) shall be made available to the Exchange in a form and manner prescribed by the Exchange and within the time frame designated by the Exchange when requested by the Exchange. Similarly, CFE Rules 502, 611(e), and 702(b) are proposed to be amended to make clear either that books and records requested by the Exchange be made

¹⁴ 17 CFR 38.603.

¹⁵ 17 CFR 1.18.

¹⁶ 17 CFR 1.25.

¹⁷ 17 CFR 1.27.

¹⁸ 17 CFR 1.31.

¹⁹ 17 CFR 1.32.

²⁰ 17 CFR 1.36.

available in a form and manner prescribed by the Exchange and/or within a time frame designated by the Exchange to the extent that this is not already stated explicitly in these rules.

CFE is also proposing to add CFE Rule 503A to its Rulebook which contains two reporting requirements. First, each Trading Privilege Holder that is a Futures Commission Merchant or Introducing Broker would be required, in a form and manner prescribed by the Exchange, to concurrently file with the Exchange a copy of all Form 1-FR-FCM, Form 1-FR-IB, or FOCUS Report Part II, IIA, or Part II CSE submissions, as applicable, made by the Trading Privilege Holder. Second, each Trading Privilege Holder that is a Futures Commission Merchant and (i) is not Clearing Member or (ii) is a Clearing Member that utilizes another Clearing Member for purposes of clearing Exchange Contracts would, in a form and manner prescribed by the Exchange, be required to provide a report to the Exchange on a daily basis which sets forth the positions, if any, in CFE Contracts of the Trading Privilege Holder's customers held by any Clearing Member in the customer range at CFE's Clearing Corporation. The receipt of this information will assist CFE in meeting its obligations under CFTC Regulations 38.603²¹ and 38.604.²²

As CFE is proposing to do with various recordkeeping requirements, CFE is also proposing to specifically incorporate into the new Appendix to Chapter 5 of its Rulebook a CFTC Regulation relating to reporting and to provide that a violation of this regulation shall be deemed a violation of a specific CFE Rule. Like with the foregoing recordkeeping requirements, the reporting requirements under this regulation already exist generally under CFE Rule 604, which requires adherence to CFTC regulations, and will now be specifically incorporated into

²¹ 17 CFR 38.603.

²² 17 CFR 38.604.

CFE's rules consistent with the provisions of CFTC Regulation 38.603.²³ In particular, CFE is proposing to add CFE Rule 519 which incorporates into CFE's Rulebook CFTC Regulation 1.10 (Financial Reports of Futures Commission Merchants and Introducing Brokers).²⁴

Trading Halts

CFE Rule 1602(i) already provides that trading in Volatility Index security futures shall be halted to the extent required by CFE Rule 417 relating to “regulatory halts” (as that term is defined in CFTC Regulation 41.1(l)²⁵). One instance of a regulatory halt under CFTC Regulation 41.1(l)²⁶ is the operation of circuit breaker procedures to halt or suspend trading in all equity securities trading on a national securities exchange or national securities association. Consistent with the foregoing and with other CFE Contract rule chapters, Rule 1602(i) also currently provides that trading in Volatility Index security futures shall be halted whenever a market-wide trading halt commonly known as a circuit breaker is in effect on the New York Stock Exchange in response to extraordinary market conditions. Because circuit breaker trading halt rules on securities exchanges are changing effective February 4, 2013,²⁷ CFE is proposing to add substantively similar circuit breaker trading halt provisions which will be applicable to all CFE products in new CFE Rule 417A. CFE is also proposing to amend Rule 1602(i) to provide that its current reference to halting for New York Stock Exchange circuit breaker halts will apply prior to February 4, 2013 and that trading shall halt pursuant to the circuit breaker halt provisions of new Rule 417A on or after February 4, 2013.

²³ 17 CFR 38.603.

²⁴ 17 CFR 1.10.

²⁵ 17 CFR 41.1(l).

²⁶ 17 CFR 41.1(l).

²⁷ See, e.g., Chicago Board Options Exchange, Incorporated Rule 6.3B.

New Rule 417A is proposed to provide that CFE shall halt trading in all CFE Contracts and shall not reopen for specified time periods if there is a Level 1, 2, or 3 Market Decline. Specifically, Rule 417A is proposed to provide that: A “Market Decline” means a decline in price of the S&P 500 Index between 8:30 a.m. and 3:00 p.m. (all times are CT) on a trading day as compared to the closing price of the S&P 500 Index for the immediately preceding trading day. The Level 1, Level 2, and Level 3 Market Declines that will be applicable for the trading day will be the levels publicly disseminated by securities information processors.²⁸ A “Level 1 Market Decline” means a Market Decline of 7%, a “Level 2 Market Decline” means a Market Decline of 13%, and a “Level 3 Market Decline” means a Market Decline of 20%. If a Level 1 or Level 2 Market Decline occurs after 8:30 a.m. and up to and including 2:25 p.m. or, in the case of an early scheduled close, 11:25 a.m., the Exchange shall halt trading in all CFE Contracts for 15 minutes after a Level 1 or Level 2 Market Decline. The Exchange shall halt trading based on a Level 1 or Level 2 Market Decline only once per trading day. The Exchange will not halt trading if a Level 1 or Level 2 Market Decline occurs after 2:25 p.m. or, in the case of an early scheduled close, 11:25 a.m. If a Level 3 Market Decline occurs at any time during the trading day, the Exchange shall halt trading in all CFE Contracts until the next trading day. If a circuit breaker is initiated in all Contracts due to a Level 1 or Level 2 Market Decline, the Exchange may resume trading in each CFE Contract anytime after the 15-minute halt period.

These changes to CFE's trading halt provisions are consistent with CFTC Regulation 38.255²⁹ which provides that DCMs must establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but

²⁸ CFE represents that the Level 1, Level 2, and Level 3 Market Declines that will be applicable for the trading day will be the levels publicly disseminated by securities information processors before 8:30 a.m.

²⁹ 17 CFR 38.255.

not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,³⁰ in general, and furthers the objectives of Section 6(b)(5)³¹ in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and 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 addition of Rule 616 relating to wash trades, Rule 617 relating to money passes, Rule 618 relating to accommodation trading, Rule 619 relating to front-running, and Rule 620 relating to disruptive practices as well as the changes to Rules 604 and 608 will augment CFE's existing rules that prohibit fraudulent and manipulative acts and practices and conduct inconsistent with just and equitable principles of trade. By specifically enumerating these provisions in CFE's Rulebook and expanding the description of improper trading practices under CFE Rules, CFE's ability to protect investors and the public interest will be enhanced.

The recordkeeping provisions that CFE is adding to Rules 414, 415, 418, 501, 518, 522, 528, 530, and 534-536 and the reporting provisions that CFE is adding to Rules 501, 502, 503A, 519, 611, and 702 will also enhance CFE's ability to protect investors and the public interest and to enforce CFE Rules that prohibit fraudulent and manipulative acts and conduct inconsistent with just and equitable principles of trade. These recordkeeping requirements are designed to

³⁰ 15 U.S.C. 78f(b).

³¹ 15 U.S.C. 78f(b)(5).

ensure that Trading Privilege Holders maintain records that enable CFE and/or other regulators to investigate whether Trading Privilege Holders are complying with applicable rules and regulations by requiring the maintenance of information that may be reviewed to determine whether or not a Trading Privilege Holder is complying with applicable regulatory requirements. Similarly, these reporting requirements are designed to enable CFE to receive and request information that allows CFE to monitor for compliance with rules and regulations, to investigate for noncompliance when appropriate, and to conduct financial monitoring with regard to CFE Trading Privilege Holders that are Futures Commission Merchants.

The new circuit breaker trading halt provisions that CFE is including in Rule 1602(i) and Rule 417A are designed to foster cooperation and coordination with persons engaged in facilitating transactions in securities and to remove impediments to and perfect the mechanism of a free and open market and a national market system. Specifically, these provisions promote uniformity across securities and futures markets concerning when and how to halt trading as a result of extraordinary market volatility which in turn facilitates the protection of investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

CFE does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.³²

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The proposed rule change will become effective on October 17, 2012.

³² 15 U.S.C. 78a et seq.

At any time within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.³³

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-CFE-2012-001 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-CFE-2012-001. 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

³³ 15 U.S.C. 78s(b)(1).

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 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices 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-CFE-2012-001, 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.³⁴

Kevin M. O'Neill
Deputy Secretary

³⁴ 17 CFR 200.30-3(a)(12).