

Regulatory Circular RG03-73

To: Members

From: Department of Financial and Sales Practice Compliance

Re: Independent Contractors

Date: September 3, 2003

Exchange Contact: Robert Gardner (786-7937)

A number of CBOE member organizations utilize individuals compensated as independent contractors to perform duties traditionally performed by employees, including securities traders and registered representatives. The purpose of this Regulatory Circular is to advise CBOE members that these individuals compensated as independent contractors are considered associated persons under Exchange Rules if they directly or indirectly control a member, are controlled by a member, or are under common control of a member.

Key Points

- Individuals compensated as independent contractors are subject to the member's supervision.
- The member employing these individuals compensated as independent contractors, and the individuals themselves, are subject to, and required to comply with, all applicable securities laws and rules, including the Constitution and Rules of the Exchange.
- Individuals designated as independent contractors are also subject to Rules of the Exchange with respect to statutory disqualification pursuant to Section 3(a)(39) of the Securities and Exchange Act of 1934, as amended.
- This Regulatory Circular does not address the issue of whether an independent contractor is deemed an employee under Internal Revenue Service rules and regulations or individual state laws.

Associated Persons Defined

Exchange Rule 1.1(qq) defines “Associated Person” or “Person Associated with a Member” as:

Any partner, officer, director or branch manager of a member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a member, or any employee of a member. [Emphasis added.]

Section 3(a)(21) of the Securities Exchange Act of 1934, as amended, contains the same definition of Person Associated with a Member as Exchange Rule 1.1(qq).

The SEC interprets the term associated person to include order-takers and any independent contractor, consultant, franchisee, or other person providing services to a broker-dealer equivalent to those persons specifically referenced in the above definition.¹ A simple denial of control of an independent contractor by a member does not remove that person’s status as an associated person of the member, or the member’s responsibility for supervising that person. To the extent that a member forms a relationship with an independent contractor, and exercises control over activities of that person or allows that person to act on behalf of the member, the person is an associated person of the member, and the member is responsible for supervising that person.² Such persons shall be referred to as “independent contractors” in the remainder of this Circular.

Independent Contractors - Subject to Member’s Supervision

Pursuant to CBOE Rule 4.2, all CBOE members are required to adhere to the Securities Exchange Act of 1934 (“Act”), as amended, rules and regulations thereunder, the Constitution and the Rules of the Exchange, and the Rules of the Clearing Corporation. Rule 4.2 also requires that every CBOE member supervise persons associated with the member to assure compliance with all applicable securities laws, rules and regulations. Members who employ “independent contractors” are not exempt from this requirement, and are responsible for establishing and carrying out procedures that will subject these “independent contractors” to effective supervision designed to monitor their securities related activities and to detect and prevent regulatory and compliance problems. Such procedures and evidence of their implementation may be subject to review during the course of an Exchange examination or investigation.

For instance, pursuant to CBOE Rule 4.18, all CBOE members (other than a lessor that is neither registered, nor required to be registered, as a broker-dealer under Section 15 of the Exchange Act) are required to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such member’s business, to prevent the misuse, in violation of the Exchange Act and Exchange Rules, of material, nonpublic information by such member or persons associated with such member. Individuals designated as “independent contractors” are subject to the policies and procedures members establish and enforce pursuant to Rule 4.18.

¹ See Securities Exchange Act Release No. 34-44992 (October 26, 2001), 66 FR 55818 (November 2, 2001).

² June 18, 1982 Letter from Douglas Scarff, Director Division of Market Regulation, Securities and Exchange Commission, to Gordon S. Macklin, President National Association of Securities Dealers.

Members employing “independent contractors” must maintain detailed records of each independent contractor’s compensation arrangement, including each purchase and sale of a security attributable, for compensation purposes, to that independent contractor.³

Members employing “independent contractors” shall also ensure that these individuals are fingerprinted in accordance with Section 17(f)(2) of the Act, and are covered by the member’s fidelity bond, if such bond is required by CBOE Rule 9.22.

Independent Contractors - Subject to Exchange Disciplinary Jurisdiction

In addition, pursuant to CBOE Rule 3.6(a), a person employed by a member who is designated as an “independent contractor” is bound by the Constitution and Rules of the Exchange and the Clearing Corporation, and is subject to the disciplinary jurisdiction of the Exchange pursuant to CBOE Rule 17.1.

Individuals designated as “independent contractors” are also subject to CBOE Rules 3.5 and 3.18 and, in particular, the provisions relating to members and persons associated with members, and applicants for membership, who become subject to a statutory disqualification pursuant to Section 3(a)(39) of the Act.

Exchange Contact Person

Any questions regarding this Circular may be directed to Robert Gardner, Department of Financial and Sales Practice Compliance, at (312) 786-7937.

(Regulatory Circular RG98-122, Revised)

³ See SEC Rule 17a-3(a)(19) and CBOE Regulatory Circular RG03-032.