



EXECUTE SUCCESS<sup>SM</sup>

## Regulatory Circular RG14-114

**Date:** July 18, 2014

**To:** Trading Permit Holders

**From:** Regulatory Services Division

**RE:** 2014 CBOE EXAMINATIONS PROGRAM PRIORITIES

The Chicago Board Options Exchange, Incorporated ("CBOE") examinations program applicable to broker-dealers that are CBOE Trading Permit Holders ("TPHs"), including those for which CBOE is the Designated Examining Authority ("DEA"), encompasses several major components. The examinations program is carried out by CBOE's Regulatory Services Division's Department of Equity Trading Regulation and Department of Member Firm Regulation.

The Department of Equity Trading Regulation conducts Market Access and Regulation NMS examinations.

The Department of Member Firm Regulation performs Financial and Operational ("FinOp") examinations of TPHs for which CBOE is the DEA. The FinOp examinations are supplemented by a Financial Surveillance unit. In addition, Trade Practice examinations of CBOE TPHs are conducted by this group.

Sales Practice examinations are currently conducted pursuant to a 17d-2 Agreement. Pursuant to the 17d-2 Agreement, Sales Practice examinations of non-FINRA CBOE TPHs for which CBOE is also the DEA are currently being conducted by the CBOE's Department of Member Firm Regulation.

### **Priorities**

CBOE plans to periodically publish examinations program priorities to highlight risks and issues. The following are 2014 examinations program priorities for CBOE thus far. The priorities highlight new and/or continuing areas of focus to the examinations program. New risks, concerns or rule requirements will continue to be integrated into the examinations program as necessary throughout the year.

#### **Market Access – SEC Rule 15c3-5**

While the examinations staff has been reviewing broker-dealers written supervisory procedures and risk controls required by the Market Access rule, the on-site testing of such procedures and controls continues. The procedures and controls are evaluated to test their effectiveness given the nature and scope of the broker-dealer's business mix.

#### **Regulation NMS**

CBOE is continuing to review broker-dealers' policies and procedures related to Reg NMS. Examination staff also reviews, where applicable, a broker dealer's use of certain exceptions or exemptions related to Reg NMS Rule 611 and policies and procedures around using those exceptions or exemptions.

### Regulation SHO

Reg SHO continues to be a primary focus for CBOE in examinations. Among other things, examinations staff continues to focus on order marking requirements, timeliness of closeouts, review for the affirmation action taken for the close-outs and *bona-fide* market making.

### Customer Reserve Computation

Protection of customer funds and securities is of the utmost importance. Broker-dealers must have adequate supervision and control over the funds and securities of their customers. Reviewing for the accuracy of a broker-dealer's customer reserve computation has been and continues to be an important part of the examinations program. In addition, CBOE focuses on possession and control of customer fully-paid and excess margin securities, verification of customer assets, and asset collateralizing customer debit balances.

### Net Capital Computation

Among other things, examinations staff continue to focus on the accuracy of a broker-dealer's net capital computation, permanency of capital and the accuracy of the attendant books and records.

- Funding – Sources of capital (e.g., sub-loans, Class B) and how the firm generates its cash-flow and funds operations (prop/market making trading, transactions, rebates, stock borrow/loan, repos/reverse repos).
- Liquidity – Comparison of a firm's liquid assets to its liabilities, how liquid are the assets, is the firm diversified or concentrated in one product group, diversification of liquidity providers.
- Off-Balance Sheet Risks – Loan commitments, letters of credit, and revolving underwriting facilities, derivative instruments, accounting for transfers and servicing of financial assets (GAAP vs. regulatory accounting).
- Monitoring of Master/Sub-Accounts – Sub-accounts and series LLC arrangements to ensure that broker-dealer class members are owners and not customers.
- Balance Sheet – Independent verification of asset, review for unrecorded liabilities, and the marketability of the broker-dealers inventory.

### Examination Coordination

CBOE is making a concerted effort to coordinate the various examinations it conducts (FinOp, Market Access, Options Market Participants, and Reg NMS) to avoid duplication of requests and efforts.

CBOE continues to work with FINRA to coordinate examinations so as to avoid duplication of efforts and interference with one another when possible.

### Regulatory Developments

CBOE recently entered into a Regulatory Services Agreement with FINRA, whereby FINRA processes registration waiver requests on behalf of CBOE TPHs.

### **Additional Information:**

Questions concerning this Regulatory Circular can be directed to the Regulatory Interpretations and Guidance line at (312) 786-8141 or [RegInterps@cboe.com](mailto:RegInterps@cboe.com).