

Testimony of
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the Illinois State Senate Revenue Committee
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Good afternoon Chair Hutchinson, Chair Bradley and Honorable Members of the joint Revenue Committees. My name is Edward Provost and I am President and Chief Operating Officer of CBOE Holdings- the parent company of the Chicago Board Options Exchange. The financial health of Illinois is of great importance to me. I was born in Champaign, Illinois, and am a life-long resident of this great state. My father was a high school teacher and he and my mother raised 13 children encouraging us all to be actively involved in church and community affairs. In addition to my professional responsibilities, I serve on the Governing Board of the Illinois Council on Economic Education, an organization that furthers financial literacy programs for school children in Illinois. My own children are products of the public school system, and appropriate funding for our schools is of keen interest to me. Professionally, I have spent my entire career at CBOE.

CBOE, which is proudly headquartered in Chicago and a leading financial product innovator and securities marketplace, is a named exchange in the proposed HB 106 financial transaction tax. All of us at CBOE share your deep concern with the state's struggling fiscal condition and the implications it has for the schools that educate our children, the agencies that assist our citizens and the future of working families statewide. I understand why the proposed transaction tax has appeal as a "silver bullet" that seemingly can remedy the state's financial struggles. However, as someone who has been involved with the U.S. securities industry for my entire career, I can tell you with great certainty that the proposed legislation will not work as intended. Not only will it fail to generate anywhere close to the projected revenues, it will change behavior in unintended and irreparable ways that will end up causing the state to lose valuable and immeasurable existing revenue, as well as benefits that Chicago currently enjoys as the financial derivatives center of the United States and, indeed, the world.

Before I explain why a financial transaction tax will not work, let me provide you with some information about CBOE. Since our establishment in 1973, our headquarters has been located in Chicago and virtually all of our close to 600 employees work in our Chicago offices. We are a Chicago company through-and-through, competing every day against deeply capitalized east coast exchanges. CBOE is not part of some international conglomerate, and we have never pursued any sort of corporate inversion tax-reducing relocation strategy. During the last four years, CBOE has paid state income taxes amounting to more than \$15 million annually as well as property taxes that run over \$1.5 million annually. This is in addition to federal income taxes that average more than \$96 million per year. Our effective tax rate in 2015 was 36.7%. We have a longstanding tutoring and mentorship program with Drake Elementary School in Chicago, and we are involved in many other local philanthropic endeavors. In short, CBOE is a good corporate citizen that pays its taxes and reinvests considerable *time and money* in the community.

As for our products and customers, I would note that options are first and foremost incredibly useful and powerful risk mitigation tools that can act as insurance for an investor's stock portfolio. Options trading is not gambling. Institutions, including pension funds, use options to complement and protect stock holdings. Importantly, individual investors nationwide use options for this very same purpose. Indeed, roughly 90% of our orders are on behalf of everyday investor accounts. I can't state strongly enough that *CBOE is nothing like a casino* as was implied in the previous hearing on this Bill, rather we are a critical part of our nation's unrivaled comprehensive financial market system that fosters unparalleled capital formation opportunities for entrepreneurs and small businesses.

Now I will explain why HB 106 will not work as intended. As an initial matter, you should know that the bulk of CBOE's revenue is generated from transaction fees. We do not have other significant revenue sources to offset the expected loss of transaction revenue as a result of a transaction tax. The proposed legislation would impose a \$2 per contract tax on financial transactions occurring on CBOE. CBOE's average per contract revenue is less than 35 cents. Please take that in - *35 cents per contract*. Thus, the proposed \$2 per contract tax would cause us to increase, *by over 500%*, the amount we collect per contract on

average. If we could charge \$2 per contract because our customers and the market could accept such a charge, we would be doing so today instead of the fraction of that amount that we currently collect. While it is not clear if the tax is intended to be paid by the Exchange, or one or both parties to each transaction, it really does not matter- the economics are not sustainable under any scenario.

An extremely relevant fact to consider when evaluating the merits of this bill, is that listed options trade on 14 options exchanges throughout the United States. 12 of those, including well-capitalized operations owned by Nasdaq and the NYSE, are located in other states including New York, Pennsylvania, California, Missouri, and Massachusetts; of course, none of which would be subject to a transaction tax. The majority of our volume on CBOE is in products that are traded on all of these competing exchanges. *It is a certainty that institutional and retail investor behavior would change the second this transaction tax went into effect.* Today, pricing differences of less than a penny per contract can and do cause brokerage firms to route order flow to other exchanges. Under the proposed \$2 per contract tax, order flow would immediately be directed to non-Illinois markets that would not be subject to any extra tax. In other areas of commerce, people travel for miles to avoid taxes on goods. Here, it would be effortless for brokerage firms to remove CBOE from their order routing tables to avoid a 500% increase in transaction costs. The net result is that the state would fall short of any projected revenue expected from the tax, and CBOE as a Chicago institution could be decimated.

Of course, if a tax that caused CBOE to lose the majority of its order flow were to be implemented, we would need to explore all options at our disposal to remain a viable entity. We understand that the CME is contemplating moving out of state if a transaction tax were to be imposed. CBOE would need to consider such an option as well. It would be an incredible loss for our city and state to surrender not only the status that comes with being a major global financial hub, but also to forgo the revenue that comes with all of the jobs and commerce that are ancillary to these exchanges. We estimate that in addition to our own employees in Illinois, tens of thousands of other well-paying jobs in finance and technology are located in our state in order to have proximity to our exchanges. Most, if not all, of the income tax and other revenue associated with those jobs would migrate elsewhere. Further, the tourism, visitors, and conferences that come to Illinois as a result of our industry are substantial and could be lost.

I ask that you not view this as a threat. We stand willing to work with you on the very difficult issues facing our state. However, we ask that you recognize that the rational and actual outcome of instituting this tax will be the loss of incredible amounts of business to entities in other states which, in turn, would cause local exchanges to do what they must in order to survive. I would also be remiss if I didn't mention that the proposed tax appears to present constitutional and jurisdictional questions that could undermine the ability to collect any anticipated revenue from a tax for a prolonged period of time. CBOE's customers are located all around the country and the globe. Indeed, CBOE's primary data center is located in Secaucus, New Jersey in order to be in close proximity to many of our customers. Moreover, the trades executed on CBOE often are initiated by persons in other states. Whether an Illinois tax could legally be applied in such interstate dealings is something we will be researching. Further the U.S. Securities and Exchange Commission must effectively approve every transaction fee imposed by CBOE (including, of course, a fee to cover or collect any transaction tax). It is entirely possible that amending our fee schedule to incorporate a transaction tax, such as the one proposed, would be scrutinized for, among other things, creating market structure-impacting pricing distortions.

As a company that facilitates the matching of buyers and sellers of securities pursuant to a well-regulated framework that insulates investors from counter-party risk and default, CBOE plays an important and positive role in our financial markets. Options exchanges did not cause our nation's financial crisis in 2008, or the stressful economic conditions facing our state today. However, I will say again that we stand ready to work with you towards a solution that provides sustainable long term benefits to all citizens of our state.

CBOE is proud of its Chicago and Illinois heritage and we thank you for the opportunity to testify. I look forward to answering your questions.