

appropriate written authorization is required for such transfers. The discussion herein focuses on the proposal to prohibit third party checks, but applies equally to funds transfers, as well as deposits and transfers of securities.

Currently, there is no prohibition in the CBOE rules or any of the securities regulations on accepting third party checks for deposit into a securities account. A majority of the CBOE's Clearing Firms will accept the check of a third party for deposit to a market-maker account, unless it would be clearly inappropriate. This is done as a convenience to market-maker customers. These checks are made payable either to the market-maker or the Clearing Firm. Before accepting such deposits, the Clearing Firm examines the relationship of the depositor to the market-maker or market-making entity to gain assurance that there is a legitimate reason for the deposit, such as the third party having an ownership interest in the market-maker's business (e.g., a member of the Limited Liability Corporation ("LLC") in the case of a market-making entity organized as an LLC).

However, by accepting third party checks, the Clearing Firm takes a business risk. While Clearing Firms make a reasonable effort to confirm that funds deposited via a third party's check are the property of the market-maker or market-making entity, and the transaction exhibits no obvious improprieties, repercussions can arise later. Some Clearing Firms have, in fact, been named as defendants in legal actions taken by third parties who allege some type of impropriety with respect to funds deposited at the Clearing Firm via their check, and seek a monetary judgment against the firm.⁵ These actions are rare, and the allegations raised against the Clearing Firm are usually without merit and ultimately dismissed. However, the legal expenses of defending an arbitration claim or lawsuit are alone a significant financial risk to Clearing Firms.

The practice of Clearing Firms accepting third party checks most likely grew as a service among Clearing Firms. Clearing Firms believe that accepting third party checks has become uneconomical when the business risks are considered, and thus believe the practice should be ended. They argue that their market-maker customers should maintain a bank checking account for their market-making

business. Clearing Firms believe that the best business practice in this regard is for Clearing Firms to accept checks from a market-maker's bank checking account, which would allow the Clearing Firm greater control over risks with only minor inconvenience to a market-maker. Market-makers could simply use their bank checking account for making deposits of third-party checks and issue checks or effect transfers to the Clearing Firm from their bank checking account. In this way, Clearing Firms need not provide banking services to their customers that could expose them to litigation risks because they are broker-dealers. The proposed rule would, in effect, allow a Clearing Firm to accept a check, funds transfer or securities transfer only if it is drawn on an account that is in the same person's or business entity's name as the account of deposit at the Clearing Firm.

Interpretations and Policies ("I&P") to the proposed rule would allow certain exceptions to the prohibitions set forth in the rule. Under proposed I&P .01, checks, funds or securities drawn on a joint account of which the market-maker is one of the joint owners are generally excepted from the prohibition. Under proposed I&P .02, if a market-maker whose account is cleared or carried by a Clearing Firm is not a sole proprietor (individual), but is structured as a partnership or corporation, the check of a third party listed as an owner on Schedule A or Schedule B of the market-making entity's Form BD may be accepted by the Clearing Firm for deposit. In order to qualify for this exception, an owner listed on Schedule B of Form BD must be a U.S. broker-dealer. Under proposed I&P .03, if a market-maker is subject to the Commission's Net Capital Rule, an officer or partner of the Clearing Firm may make a written exception to the prohibition if the market-maker's net capital falls below the applicable minimum. In addition, an officer or partner of a Clearing Firm may make a written exception if the equity in the market-maker's account is not sufficient based on the Clearing Firm's internal risk control analysis, or if net liquidating equity becomes negative.

Under proposed I&P .04, transfers of funds and/or securities between different name accounts that are cleared and carried by the same Clearing Firm are permitted if the Clearing Firm obtains written authorization for the transfer from the owner of the account from which the funds and/or securities would be withdrawn. Lastly, proposed I&P .05 sets forth retention requirements for the Clearing Firm documentation

evidencing exceptions and authorizations to transfer funds and securities between accounts.

The CBOE believes that the uncertainty surrounding third party deposits justifies prohibition by rule. The CBOE further believes that while each Clearing Firm could make a business decision to refuse to accept third party checks, funds transfers and securities, a rule is needed to establish a uniform, safe practice.

2. Statutory Basis

The proposed rule is intended to eliminate an unnecessary practice and promote a greater level of financial safety and soundness across Clearing Firms. As such, the CBOE believes that the proposed rule change is consistent with and furthers the objectives of section 6(b)(5) of the Act,⁶ in that it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market, and to protect investors and the public interest.

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

CBOE does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the CBOE consents, the Commission will:

(A) By order approve such proposed rule change; or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing,

⁵ In the case of a business relationship between a third party and a market-maker, a claim may arise due to trading losses.

⁶ 15 U.S.C. 78(f)(b)(5).