

December 3, 1976

TO: Bob Barr

FROM: Lee T. Ponton
Director of Policy Planning

RE: Trading Procedure Department - A Functional Description

Investigative Section

The Investigative Section of the Trading Procedure Department (TPD) responds to complaints from members or other persons who allege that one or more of the Rules of the Exchange have been broken by a member or members on the trading floor of the Exchange. The Investigators must prepare a written report relating to any inquiry or complaint forwarded to them by a member or public customer. And every complaint, regardless of its basis in fact, must be met with a written reply from the department.

The results of all investigations are prepared for the review of the Business Conduct Committee (BCC). The BCC then determines if the investigative reports warrant a formal Statement of Charges against specific individuals. If a Statement of Charges is issued in a particular case, the alleged violator of a Rule or Rules is brought before the BCC in a formal hearing. Investigative staff members then must present the position of the Exchange in the matter and take part in the hearing and the implementation of the BCC's decision.

In this section there is a Director who has complete charge of the functions of the section and works closest with the BCC. The Supervisor manages the daily operation of the Department and helps to apportion the case load between the six Investigators. The Investigators work in two-person teams to proceed with investigations. Though some complaints require little more than a few hours of fact-gathering, some complaints bloom into major investigations involving a group of members. Thus, one team may spend weeks on a single case, causing a backlog of inquiries to develop. At the current time (December, 1976) there is a backlog of more than 40 inquiries that must be investigated.

Because of this backlog, and the prospects that it will certainly increase in the months to come as the CBOE expands to put

trading, the TPD proposes to add three additional Investigators to the staff. This would allow the Investigators to work in 3-person teams to proceed with investigations. It should be noted that because of increased Surveillance activities and greater sophistication of Exchange systems, the Investigative section has been receiving a great many more inquiries for investigation from the Surveillance Section. Of the inquiry backlog mentioned earlier, at least half of these inquiries originated internally from Surveillance. Since Surveillance is a priority activity on the CBOE, it is safe to anticipate that inquiries from this section will increase almost geometrically in the next months. More inquiries result in more investigations which cause the pressing need for more Investigators.

We would also note that for the first half of FY 1977, the Investigative section had requested approval of two additional Investigation staff positions. These were subsequently deleted during budget talks last spring. There is a real need for more staff in this area right now.

Surveillance Section

The Surveillance Section monitors option trading in Chicago and any possible external influences upon the CBOE market. They survey the trade tape data, computer analyses of member trading, trade ticket information, news topics, and any other indications of CBOE activity. Raw data is analyzed by a variety of computer programs which point out irregularities for further review. When the irregularities seem to evidence possible Rule violations, they are forwarded to the Investigative staff and eventually to the BCC. The SEC maintains a dialogue with the section and suggests new areas of surveillance regularly.

Two Supervisors report to the Director of Surveillance. One Supervisor manages a clerical staff of four market data clerks (plus two open positions for clerks). The other supervisor manages two analysts who work on detailed prospects resulting from the compilation of data by the clerks.

Again it is well known that the area of surveillance is seen as very important by the SEC and all CBOE officials. The section has embarked on a program of computer support for its activities and has a definite need for two additional clerks to evaluate the many new reports now being produced.

The CBOE is, by virtue of its own success in the options field, the most important research facility in the country for option trading. It is only half correct to say that the CBOE must increase its surveillance capabilities because the SEC or other agencies are unable to accomplish such surveillance. The CBOE must have the most complete surveillance program in the nation for options because of our great volume - this is the only place where one can learn from listening to the "pulse" of options activity. We must be aware of our obligations to help others

understand how our market functions in order to inform other regulatory agencies of the true nature of the options business and dispel any misunderstandings or half-understandings of the significance of this marketplace.

Project Development

The Director of Project Development and a manager in this section are currently involved in staff support of the Board-level task force on equity trading. Research work is being done by those two staff members into the regulatory framework of CBOE equity trading and eventual practical procedures which will be employed on the Exchange.

Policy Planning

The Director of Policy Planning is the staff liaison to the Floor Procedure Committee and the Floor Officials Committee. He edits and publishes all memoranda from these committees, including the monthly Floor Report. The manager of Member Performance Evaluation is responsible for the conduct of the Market-Maker and Board Broker Evaluation Programs. His staff maintains files on all Market-Makers and Board Brokers, noting their assignments and trading activity. The position of a statistical clerk in this section will be filled by the end of 1976.

Trading Services

The Director of Trading Services provides a communications link between interested members and member firms and the Committees or staff departments of the Exchange who may be able to address their questions or problems. He is in a position to quote the policy of the Exchange on a wide variety of matters and works toward practical solutions to trading floor problems and creation of new policies and procedures to address unforeseen situations.

Conclusion

This has been an outline of the various functions of each section of the TPD. The Vice President of Trading Procedure will be anxious to discuss these positions in greater detail with any members of the Finance Committee at any time.

LTP:bsd

Verbal to com from Barr.