



UPDATED: The Latest on the SEC's Consideration of the Proposed Acquisition of Chicago Stock Exchange

Jay B. Sykes

Legislative Attorney

March 7, 2018

UPDATE: On February 15, 2018, the SEC [disapproved](#) CHX's proposed rule change. The SEC based its decision on CHX's inability to provide sufficient documentation verifying the relationships between and the sources of funds used by certain proposed upstream owners. Because of these deficiencies, the SEC explained that it was unable to find that the proposed rule change was consistent with the Exchange Act's requirements that (1) CHX enforce compliance with ownership and voting limitations in its proposed rules, and (2) the SEC be capable of exercising sufficient oversight over national securities exchanges. On March 5, CHX [announced](#) that it will no longer pursue a deal with NA Casin Holdings in light of the SEC's decision.

The original post from August 29, 2017, follows below.

In the latest development in a transaction originating last year, on August 9, the Securities and Exchange Commission (SEC or Commission) [stayed](#) an [order](#) (i.e., temporarily prevented the order from going into effect) issued by its Division of Trading and Markets (Division) approving a proposed rule concerning the acquisition of the Chicago Stock Exchange (CHX). CHX is one of 21 national securities exchanges registered with the SEC, and a group of investors that includes a number of Chinese entities with possible ties to the Chinese government is attempting to acquire the exchange. The proposed rule would approve changes to the certificates of incorporation and bylaws of CHX and its parent company to effectuate the proposed acquisition. The Division approved the acquisition subject to an amendment that purported to address concerns raised in comments that were provided to the SEC over the past several months. Perhaps most notably, the comments included those filed by a number of federal lawmakers who voiced concerns over the possibility of Chinese-government influence over the prospective acquirers of CHX.

As background, the Securities and Exchange Act of 1934 (the "Exchange Act") [controls](#) what types of

Congressional Research Service

7-5700

www.crs.gov

LSB10092

entities can operate as securities exchanges. The Exchange Act provides that an entity may operate as a securities [exchange](#) only if it is registered with the SEC as a national securities exchange under [Section 6](#) of the Exchange Act or exempted from such registration by the SEC due to the limited volume of transactions it processes. When an exchange registers with the SEC as a national securities exchange, it becomes a self-regulatory organization [charged with](#) “certain quasi-governmental functions and responsibilities” that are “fundamental to the enforcement of the federal securities laws.” Specifically, a national securities exchange [must](#) (1) enforce compliance of its members with federal securities laws and regulations and with its own internal rules; (2) discipline its members when it finds such violations; and (3) promulgate rules related to fair representation in governance, burdens on competition, the prevention of fraudulent or manipulative practices, the promotion of trade, and the prevention of unfair discrimination. Moreover, the Exchange Act requires that national securities exchanges obtain Commission approval for proposed rule changes, and that rule changes proposed by national securities exchanges be published in the Federal Register for notice and comment. The Commission may approve a proposed rule change only if it finds that the change would be consistent with Section 6’s general requirements for registration as a national securities exchange.

With these requirements in mind, CHX filed a [proposed rule change](#) with the Commission on December 6, 2016, concerning the acquisition of CHX by North America Casin Holdings, Inc. (“NA Casin Holdings”), an entity in which a Chinese firm, Chongqing Casin Enterprise Group Co., LTD (“Chongqing Casin”), owns the largest stake. As discussed, the proposed rule would approve changes to the certificates of incorporation and bylaws of CHX and its parent company to effectuate the proposed acquisition.

After the Commission published the proposed rule, it received numerous comments opposing the transaction, including a December 22, 2016 [letter](#) from five Members of the House of Representatives “urg[ing the Commission] to consider the negative impacts Chinese state-affiliated ownership of [CHX] will have on national security and the financial security of the American marketplace.” Specifically, the Members argued that “Chinese markets maintain zero transparency and are heavily dominated by the Chinese State Council.” Because of this lack of transparency and Chongqing Casin’s involvement “in a number of market sectors that would require close ties to the state,” the Members asserted that “there is no way to refute concerns related to government influence over [Chongqing Casin].” The Members further claimed that because “the Chinese government remains the number one state-sponsor of cyber-espionage and corporate theft,” Chinese-government influence over the prospective acquirers of CHX poses dangers to U.S. national security and the intellectual property of American companies.

In January 2017, the Commission [instituted proceedings](#) to determine whether to approve the proposed rule. After receiving 21 additional comments and a response letter from CHX, the Commission [opted](#), pursuant to its [authority](#) under the Exchange Act, to extend the 180-day period for considering the proposed rule by 60 days, making the new deadline August 9, 2017. During the extended comment period, 11 Members of the House (including 3 who had signed the first letter) [wrote](#) to the Commission on July 10, 2017 and “strongly urge[d]” it to deny the proposed transaction. The letter expressed concern about the “opaque upstream ownership” of the prospective acquirers. The Members further maintained that other Chinese entities operating in the U.S. have attempted to evade regulation by invoking [sovereign immunity](#) and limitations on the [extraterritorial application](#) of U.S. laws. Thus, the lawmakers argued, the proposed transaction appeared to be inconsistent with Section 6 of the Exchange Act, which, as discussed, requires that national securities exchanges be able to comply with and enforce rules concerning fraudulent and manipulative practices and investor protection. Senator Joe Manchin also [wrote](#) to the Commission during the extended comment period to express concern about Chinese-government influence over the prospective acquisition of CHX and about the national-security implications of the proposed transaction.

In an apparent response to these concerns, on August 7 CHX filed an [amendment](#) to its proposed rule change. The amendment altered the proposed certificates of incorporation of CHX's parent company and NA Casin Holdings (and other CHX documents) to require, among other things:

- notice be provided to the Commission of any changes in the ownership of NA Casin Holdings;
- periodic independent audits to ensure that CHX is complying with ownership limitations imposed elsewhere in the proposed rule;
- that CHX adopt rules to ensure that only CHX regulatory personnel have access to Consolidated Audit Trail data ("CAT data"), and that CHX regulatory personnel do not provide CAT data to any other personnel of CHX's parent or NA Casin Holdings, or to any upstream beneficial owners of those corporations. (CAT data generally consist of records of orders, cancellations, and completed trades related to certain securities that national securities exchanges must submit to a central repository overseen by the SEC.).

The amendment also supplemented certain representations made by each owner of NA Casin Holdings attesting that it is not controlled or owned by any governmental entity. Finally, the amendment provided signed "Investor Statements" from each owner of NA Casin Holdings irrevocably submitting to the jurisdiction of U.S. federal courts.

When the consideration period closed on August 9, the Division issued an order approving the proposed rule as amended, but the Commission [stayed](#) the order that same day. In the order, the Division [concluded](#) that the proposed rule change was consistent with Section 6 of the Exchange Act in light of the amendment's proposed ownership and voting limitations, provisions relating to compliance with U.S. law, consent to U.S. jurisdiction by prospective upstream owners, books and records provisions, and notice and audit requirements. The order also noted that the Department of the Treasury's Committee on Foreign Investment in the United States, which is responsible for reviewing certain transactions involving foreign investors for national security concerns, had approved the proposed transaction.

It is unclear when the stay will be lifted, as the Commission's notice of the stay indicates that the order is stayed "until the Commission orders otherwise." If the Commission lifts the stay and acts on the order, its decision would be subject to judicial review if a party injured by the SEC's order pursues litigation. As discussed, [Section 6](#) of the Exchange Act requires that national securities exchanges be capable of enforcing federal securities laws and regulations, and of adopting and enforcing rules of their own related to fair representation in governance, burdens on competition, and the prevention of fraudulent or manipulative practices, among other things. A litigant seeking to challenge the Commission's final decision to approve or disapprove the proposed rule change pursuant to Section 6 would need to demonstrate that the decision is "[arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.](#)" (For more information on the types of agency actions that violate this standard, see this [CRS report](#)).

Given the interest several Members of Congress have voiced in the proposed rule change, and [recent increases in Chinese investment](#) in the U.S. more generally, the Commission's ultimate decision on the CHX acquisition is likely to generate additional consideration from the legislative branch and beyond. More broadly, the SEC's treatment of the CHX deal may have, at least in the view of some [commentators](#), far-reaching effects for how regulatory agencies will generally approach Chinese investments in the U.S. financial sector going forward, making the CHX acquisition noteworthy.