Amendment No. 2 to the proposed rule
December 20, 2016, the Exchange filed
Exhibit 1 thereto, in their entirety. On
and replaced the Form 19b–4, and
change. On December 20, 2016, the
Commission filed with the
Securities and Exchange Commission
Mercury” or “Exchange” filed with the
Securities Exchange Act of 1934
ISEMercury–2016–22
BILLING CODE 8011–01–P
SECURITIES AND EXCHANGE COMMISSION
[Release No. 34–79663; File No. SR–
ISEMercury–2016–22]
Self-Regulatory Organizations; ISE
Mercury, LLC; Notice of Filing of
Proposed Rule Change, as Modified by
Amendment Nos. 1 and 2, To Permit
Nasdaq Execution Services, LLC To
Become an Affiliated Member of the
Exchange To Perform Certain Routing and
Other Functions
December 22, 2016.
Pursuant to Section 19(b)(1) of the
Securities Exchange Act of 1934
(“Act”)
and Rule 19b–4 thereunder,
notice is hereby given that on December 9, 2016, ISE Mercury, LLC (“ISE
Mercury” or “Exchange”) filed with the
Securities and Exchange Commission
(“Commission”) the proposed rule
change. On December 20, 2016, the
Exchange filed Amendment No. 1 to
the proposed rule change, which amended
and replaced the Form 19b–4, and
Exhibit 1 thereto, in their entirety. On
December 20, 2016, the Exchange filed
Amendment No. 2 to the proposed rule
change.
The proposed rule change, as
modified by Amendment Nos. 1 and 2,
is described in Items I, II, and III below,
which Items have been prepared by the
Exchange. The Commission is
publishing this notice to solicit
comments on the proposed rule change,
as modified by Amendment Nos. 1 and
2, from interested persons.
I. Self-Regulatory Organization’s
Statement of the Terms of Substance of
the Proposed Rule Change

The Exchange proposes to (1) permit
the Exchange to receive inbound orders in
options routed through Nasdaq
Execution Services, LLC (“NES”) from
certain affiliated exchanges, as
described in detail below, by
establishing procedures designed to
prevent potential informational
advantages resulting from the affiliation
with NES; and (2) grant the Exchange an
exemption to permit NES, an affiliate of
the Exchange, to become a Member of
the Exchange in order to perform certain
routing on [sic] other functions on
behalf of the Exchange.

II. Self-Regulatory Organization’s
Statement of the Purpose of, and
Statutory Basis for, the Proposed Rule
Change

In its filing with the Commission, the
Exchange included statements
concerning the purpose of and basis for
the proposed rule change and discussed
any comments it received on the
proposed rule change. The text of those
statements may be examined at the
places specified in Item IV below.
The Exchange has prepared summaries, set
forth in sections A, B, and C below, of
the most significant aspects of such
statements.

A. Self-Regulatory Organization’s
Statement of the Purpose of, and
Statutory Basis for, the Proposed Rule
Change

1. Purpose

The purpose of the filing is to permit
ISE Mercury to receive inbound orders in
options routed through Nasdaq
Execution Services, LLC (“NES”) from
some affiliated exchanges, as
described herein and establish
procedures designed to prevent
potential informational advantages
resulting from the affiliation between
ISE Mercury and NES. The Exchange
requests approval to permit NES, an
affiliate of the Exchange, to become a
Member of the Exchange in order to
perform inbound routing on behalf of
the Exchange. The Exchange is also
filing to permit ISE Gemini [sic] to route
outbound orders through NES either
directly or indirectly through a third
party routing broker-dealer to other
market centers and perform other
functions regarding the cancellation of
orders and the maintenance of a NES
error account.

Restriction on Affiliation

NES is a broker-dealer owned and
operated by Nasdaq, Inc. NES is
affiliated with International Securities
Exchange, LLC (“ISE”), ISE Gemini, ISE
Mercury LLC, NASDAQ PHLX LLC
(“Phlx”), The NASDAQ Options Market
LLC (“NOM”) and NASDAQ BX, Inc.
(“BX”). For purposes of this filing the
term “Affiliated Entities” shall refer to
ISE, ISE Gemini, Phlx, NOM and BX
(collectively “Affiliated Entities”).
Currently, NES is a member of Phlx,
NOM and BX (collectively “NASDAQ
Exchanges”) and provides all options
routing functions for Phlx, NOM and
BX.

Today, Phlx Rule 985 (Affiliation and
Ownership Restrictions), The NASDAQ
Stock Market LLC (“Nasdaq”) Rule 2160
(Restrictions on Affiliation) and BX
Rule 2140 (Restrictions on Affiliation)
currently prohibit the Nasdaq
Exchanges or any entity with which it
is affiliated from, directly or indirectly,
acquiring or maintaining an ownership
interest in, or engaging in a business
venture with, a Nasdaq Exchange
member or an affiliate of a Nasdaq
Exchange member in the absence of an
effective filing under 19(b) of the Act.
Specifically, in connection with prior
filings, the Commission has expressed
cconcern that the affiliation of an
exchange with one of its members
raises the potential for unfair competitive
advantage and potential conflicts of
interest between an exchange’s
self-regulatory obligations and its
commercial interests. NES performs

* The ability to route orders to other exchanges
using either the Exchange’s affiliated broker-dealer
(NES) or a third party unaffiliated broker-dealer,
which the Exchange may choose to use, is for
efficiency and potential cost savings.

* The ability to route orders to other exchanges
using either the Exchange’s affiliated broker-dealer
(NES) or a third party unaffiliated broker-dealer,
which the Exchange may choose to use, is for
efficiency and potential cost savings. See ISE–2016–
27 (not published) which amends ISE Chapter 19,
Rules 1901, 1903, 1904 and 1905. The ISE rule
changes impact ISE Mercury because Chapter 19 is
incorporated by reference into the ISE Mercury
Rulebook.

* ISE, ISE Gemini and ISE Mercury are
collectively referred to as “ISE Exchanges.”

* See Phlx Rule 1080(m) and Nasdaq and BX
Rules at Chapter VI, Section 11.

* NOM is a facility of Nasdaq.

(January 28, 2014), 79 FR 6244 (February 3, 2014)
(SR–Phlx–2014–65); 71419 (January 28, 2014), 79
Continued
similar functions for the Nasdaq Exchanges and is a member of those three markets respectively.10

Similarly, NES would be prohibited from becoming an ISE Mercury member pursuant to ISE Mercury Rule 309, titled “Limitation on Affiliation between the Exchange and Members,” without Commission approval. Specifically, a Member may not become an affiliate of the Exchange, or any facility of the Exchange, or any entity with which the Exchange or any facility of the Exchange is affiliated such as the Affiliated Entities. This rule change requests permission from the Commission to allow NES, an affiliate of ISE Mercury to become a Member of ISE Mercury for the purposes of performing certain functions, including, but not limited to receiving inbound orders from one of the Affiliated Entities.

In order for NES to be a Member of ISE Mercury, the Exchange proposes to permit the acceptance of inbound orders that NES routes in its capacity as a facility of the Affiliated Exchanges11 subject to certain limitations and conditions as follows:

- First, ISE Mercury shall maintain a Regulatory Services Agreement (“RSA”) with FINRA, as well as an agreement pursuant to Rule 17d–2 under the Act (“17d–2 Agreement”).12 Pursuant to the RSA and the 17d–2 Agreement, FINRA will be allocated regulatory responsibilities to review NES’s compliance with certain Exchange rules.13 Pursuant to the RSA, however, ISE Mercury retains ultimate responsibility for enforcing its rules with respect to NES.
- Second, FINRA will monitor NES for compliance with the Exchange’s trading rules, and will collect and maintain certain related information.14
- Third, FINRA will provide a report to the Exchange’s chief regulatory officer (“CRO”), on a quarterly basis, that: (i) Quantifies all alerts (of which the Exchange or FINRA is aware) that identify NES as a participant that has potentially violated Commission or Exchange rules, and (ii) lists all investigations that identify NES as a participant that has potentially violated Commission or Exchange rules.
- Fourth, ISE Mercury has in place Rule 309. The Exchange proposes to adopt a new paragraph (b) to Rule 309 to state that Nasdaq, Inc., as the holding company of ISE Mercury and NES, to [sic] establish and maintain procedures and internal controls reasonably designed to ensure that NES does not develop or implement changes to its system, based on non-public information obtained regarding planned changes to ISE Mercury’s system, obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated Exchange Members, in connection with the provision of inbound order routing to the Exchange.15

The Exchange also proposes to add the letter “(a)” in front of the existing paragraph in Rule 309.

### Inbound Routing

ISE Mercury Rule 309 is being amended to add rule language similar to Phlx Rule 985(c)(2). This new rule text provides that Nasdaq, Inc. which owns NES and ISE Mercury, shall establish and maintain procedures and internal controls reasonably designed to ensure that NES does not develop or implement changes to its system on the basis of non-public information regarding planned changes to the Exchange’s systems, obtained as a result of its affiliation with the Exchange, until such information is available generally to Exchange members in connection with the provision of inbound routing to the Exchange.16

By meeting the conditions described above under Restrictions on Affiliation, ISE Mercury will have set up mechanisms that protect the independence of ISE Mercury’s regulatory responsibilities, with respect to NES, as well as demonstrate that NES cannot use any information advantage it may have because of its affiliation with ISE Mercury.

The Exchange has approval from the Financial Regulatory Authority (“FINRA”)17 and The Options Clearing Corporation (“OCC”)18 for NES to perform these functions.

The Exchange notes that the Nasdaq Exchanges are separately filing rule changes to permit NES to route orders inbound from ISE Mercury to the Nasdaq Exchanges.19

### Outbound Routing

ISE has rules in place in Chapter 19 related to routing orders, which rules impact routing on ISE Mercury because those rules are incorporated by

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11 17 CFR 240.17d–2. FINRA will review NES’ compliance for certain common rules. The RSA with FINRA specifies the types of business activities that NES may undertake and it also indicates the obligations to which NES is subject under the RSA. Among other things, NES must maintain a certain amount of net capital pursuant to SEC Rule 15c3–1(a)(1)(ii) and operate pursuant to SEC Rule 15c3–3(b)(2)(iii). NES is permitted to route orders to the appropriate market center for execution in accordance with member order and requirements.

12 Similarly, Phlx Rule 985 also prohibits a Phlx member from being or becoming an affiliate of Phlx, or an affiliate of an entity affiliated with Phlx, in the absence of an effective filing under Section 19(b). See Phlx Rule 985(b)(1)(A). Phlx filed a rule proposal and received approval based on meeting the four conditions specified above to protect the independence of the Exchange’s regulatory responsibility with respect to NES, and has demonstrated that NES cannot use any information advantage it may have because of its affiliation with the Exchange.

13 The Membership Agreement as between NES and FINRA, dated January 15, 2014, provides that NES may “[engage in the following types of business: Route orders in equities and options to the appropriate market center for execution in accordance with member order and requirements.”

14 On December 5, 2013 OCC provided NES membership approval.

Linkage Handlers for purposes of routing options orders from the ISE Exchanges. Today, Phlx does not have a similar provision and ISE is removing it from this rule.

Implementation

The Exchange notes that with respect to the Rules in Chapter 19, Rules 1901, 1903, 1904 and 1905, these rules impact not only the ISE market but also ISE Mercury because Chapter 19 is incorporated by reference into the ISE Mercury Rulebook. ISE Mercury will be implemented in Q3 2017 on a symbol by symbol basis. The Exchange will add notations in the ISE Mercury Rulebook to cross reference the amended rule text and make clear the implementation date.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b)(5) of the Act, in general, and furthers the objectives of Section 6(b)(5) of the Act, in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, because the proposed rule change will allow the Exchange to receive inbound orders from each Affiliated Entity through NES, acting in its capacity as a facility of the respective Affiliated Entity, in a manner consistent with prior approvals and established protections. The Exchange believes that these conditions establish mechanisms that protect the independence of the Exchange’s regulatory responsibility with respect to NES, as well as ensure that NES cannot use any information it may have because of its affiliation with the Exchange to its advantage.

Further, the Exchange notes that its proposal is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system because ISE Mercury will have set up mechanisms that protect the independence of ISE Mercury’s regulatory responsibilities, with respect to NES, as well as demonstrate that NES cannot use any information advantage it may have because of its affiliation with ISE Mercury. The Exchange will not be granting any preferential access to information from the Exchange’s Order Book to NES. As an affiliated routing broker, NES would not be treated differently than any other unaffiliated routing broker.

The proposal should remove impediments to and perfect the mechanism of a free and open market and a national market system by providing customer order protection and by facilitating trading at away exchanges so customer orders trade at the best market price. The proposal should also protect investors and the public interest by fostering compliance with the Options Order Protection and Locked/Crossed Market Plan. In addition, the Exchange believes that the proposal is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, because of the specific protections pertaining to the routing broker, in light of the potential conflict of interest where the member routing broker could have access to information regarding other members’ orders or the routing of those orders. These protections include the Exchange’s control over all routing logic as well as the confidentiality of routing information.

The Exchange believes that its proposal related to the cancellation of orders and error account is consistent with the Act because NES’s or the Exchange’s ability to cancel orders during a technical or systems issue and to maintain an error account facilitates the smooth and efficient operations of the market. Specifically, the Exchange believes that allowing NES or the Exchange to cancel orders during a technical or systems issue would allow the Exchange to maintain fair and orderly markets. Moreover, the Exchange believes that allowing NES to assume error positions in an error account and to liquidate those positions, subject to the conditions set forth in the proposed amendments to Rule 1904 would be the least disruptive means to correct these errors, except in cases where NES can assign all such error positions to all affected members of the Exchange. Overall, the proposed amendments are designed to ensure full trade certainty for market participants and to avoid disrupting the clearance and settlement process. The proposed amendments are also designed to provide a consistent methodology for handling error positions in a manner that does not discriminate among members. The proposed amendments are also consistent with Section 6 of the
Act insofar as they would require NES to establish controls to restrict the flow of any confidential information between the third-party broker and NES/the Exchange associated with the liquidation of error positions.34

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Receiving orders through NES does not raise any issues of intra-market competition because it involves inbound routing from an affiliated exchange. This proposal provides that Nasdaq, which owns NES and the Exchange, shall establish and maintain procedures and internal controls reasonably designed to ensure that NES does not develop or implement changes to its system on the basis of non-public information regarding planned changes to the Exchange’s systems, obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated Exchange members and member organizations in connection with the provision of inbound routing to the Exchange. Utilizing NES as the routing broker does not create any undue burden on intramarket competition because NES cannot use any information advantage it may have because of its affiliation with ISE Mercury. The Exchange will not be granting any preferential access to information from the Exchange’s Order Book to NES. As an affiliated routing broker, NES would not be treated differently than any other unaffiliated routing broker.

The proposal does not result in a burden on competition among exchanges, because there are many competing options exchanges that provide routing services, including through an affiliate. Further, the proposal does not raise issues of intramarket competition, because the Exchange’s decision to route through a particular routing broker would impact all participants equally.

With respect to the proposal to establish error accounts, the Exchange’s proposal does not result in a burden on competition among exchanges because NES or the Exchange’s ability to cancel orders during a technical or systems issue and to maintain an error account facilitates the smooth and efficient operations of the market for all impacted members. The proposals regarding assumption of error positions

and [sic] to liquidation of those positions ensures certainty for all impacted market participants. The proposal does not discriminate among Members.35

C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 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 Exchange consents, the Commission shall: (a) By order approve or disapprove 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, including whether the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments

• Use the Commission’s Internet comment form (http://www.sec.gov/rules/sro.shtml); or
• Send an email to rule-comments@sec.gov. Please include File Number SR–ISEMercury–2016–22 on the subject line.

Paper Comments

• Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090. All submissions should refer to File Number SR–ISEMercury–2016–22 on the subject line. Paper Comments should be submitted no later than 30 days, 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 Exchange consents, the Commission shall: (a) By order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, To Amend the Exchange’s Rules Regarding Routing of Orders, Cancellation of Orders, and Handling of Error Positions, and Permit Nasdaq Execution Services, LLC To Become an Affiliated Member of the Exchange To Perform Certain Routing and Other Functions

December 22, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) 1 and Rule 19b–4 thereunder, 2 notice is hereby given that on December 9, 2016, the International Securities Exchange, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change. On December 20, 2016, the Exchange filed Amendment No. 1 to the proposed rule.

34 Id.


