SECURITIES AND EXCHANGE COMMISSION  


Self-Regulatory Organizations; ISE Gemini, LLC; ISE Mercury, LLC; Order Granting Approval of Proposed Rule Changes, as Modified by Amendment Nos. 1 and 2 Thereto, To Permit Nasdaq Execution Services, LLC To Become an Affiliated Member of Each Exchange To Perform Certain Routing and Other Functions  

February 9, 2017.  

I. Introduction  

On December 9, 2016, ISE Gemini, LLC (“ISE Gemini”) and ISE Mercury, LLC (“ISE Mercury,” and each of ISE Gemini and ISE Mercury an “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) and Rule 19b–4 thereunder, proposed rule changes, as modified by Amendment Nos. 1 and 2 Thereto, To Permit Nasdaq Execution Services, LLC To Become an Affiliated Member of Each Exchange To Perform Certain Routing and Other Functions. The proposed rule changes, each as modified by Amendment Nos. 1 and 2, were published for comment in the Federal Register on December 29, 2016. The Commission received no comments on the proposed rule changes. This order grants approval of the proposed rule changes, each as modified by the respective Amendment Nos. 1 and 2.  

II. Background  

On June 21, 2016, the Commission approved a proposed rule change relating to a corporate transaction in which Nasdaq, Inc. would become the ultimate parent of International Securities Exchange, LLC (“ISE”), ISE Gemini, and ISE Mercury (collectively, the “ISE Exchanges”). The transaction closed on June 30, 2016. Nasdaq, Inc. is the ultimate parent of NASDAQ BX, Inc. (“BX”). The NASDAQ Stock Market LLC (“NASDAQ”), and NASDAQ PHLX LLC (“PHLX”) and, together with Nasdaq and BX, the “Nasdaq Exchanges”. Nasdaq, Inc. is also the ultimate parent of NETS, a broker-dealer that is a member, and affiliate, of each of the Nasdaq Exchanges. As a result of this transaction, the ISE Exchanges and the Nasdaq Exchanges became affiliates of, and NES became an affiliate of the ISE Exchanges.  

As described in more detail below, ISE Gemini and ISE Mercury have now proposed rule changes (1) to permit each respective Exchange to receive inbound orders in options routed through NES from the Affiliated Exchanges, pursuant to certain limitations and conditions; and (2) to permit NES to become a Member of each Exchange to perform certain routing and other functions.  

ISE Gemini and ISE Mercury’s respective rulebooks incorporate by reference Chapter 19 of ISE’s rulebook, which contains rules relating to the routing of orders, cancellation of orders, and handling of certain error positions. ISE submitted a related proposed rule change to: (1) Route outbound orders in orders listed and open for trading on ISE’s system to away markets through NES, either directly or through a third-party routing broker-dealer; (2) adopt rules regarding the cancellation of orders and the handling of certain error positions, including maintenance by NES of an error account; and (3) make related conforming changes. These ISE rules, which the Commission is also approving today, concerning the outbound routing of orders, cancellation of orders, and handling of error accounts, will be incorporated by reference into ISE Gemini and ISE Mercury’s rules, and are similar to ISE Mercury (with respect to ISE Gemini), are referred to herein as the “Affiliated Exchanges.”  


3 A “Member” is an organization that has been approved to exercise certain trading rights on the Exchange. See ISE Gemini Rule 100(a)(23); ISE Mercury Rule 100(a)(23).  

4 Each Amendment No. 2 amended the description of one of the inbound routing
rules of Phlx, as well as the other Nasdaq Exchanges. Finally, ISE Gemini and ISE Mercury requested that the Commission approve their proposals to permit NES to become a Member of each respective Exchange, as required by ISE Gemini Rule 309 and ISE Mercury Rule 309 because of NES’s affiliation with the Exchanges. to perform certain functions relating to routing orders inbound from the Affiliated Exchanges, the outbound routing of orders to away markets, cancellation of orders, and the maintenance of an error account. 

III. Discussion and Commission Findings

After careful review, the Commission finds, as discussed in more detail below, that the proposed rule changes, as modified by Amendment Nos. 1 and 2, are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission finds that the proposed rule changes, as modified by Amendment Nos. 1 and 2, are consistent with Section 6(b)(1) of the Act, which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purpose of the Act, to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange. Further, the Commission finds that the proposed rule changes, as modified by Amendment Nos. 1 and 2, are consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster competition, and capital formation. See 15 U.S.C. 78c(f).

A. Restriction on Affiliation

As noted above, ISE Gemini and ISE Mercury proposed that NES be permitted to become a Member of each respective Exchange to perform certain routing and other functions, as described in more detail below. Absent Commission approval, ISE Gemini Rule 309 and ISE Mercury Rule 309 would prohibit NES from becoming a Member of either Exchange because of its affiliation with each Exchange and its affiliation with affiliates of each Exchange. Specifically, pursuant to ISE Gemini Rule 309, without prior Commission approval, a Member of the Exchange “shall not be or become an affiliate of, or have any facility of the Exchange, or any entity with which the Exchange or any facility of the Exchange is affiliated.” ISE Mercury Rule 309 contains the same restriction.

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest and the potential for unfair competitive advantage. Although the Commission continues to be concerned about potential unfair competition and conflicts of interest between an exchange’s self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, the Commission believes that it is consistent with the Act, as discussed in more detail below, to permit NES, an affiliate of each Exchange, to be a Member of each Exchange to perform each of the proposed functions, subject to the proposed limitations and conditions. The Commission also believes that the proposed limitations and conditions will mitigate the concerns about potential conflicts of interest and unfair competitive advantage, and that each Exchange’s proposed rules are designed to ensure that NES cannot use any information advantage it may have because of its affiliation with each Exchange.

B. Inbound Routing

As discussed above, NES is currently a member of each Nasdaq Exchange. NES also operates as a facility of each of Nasdaq, Phlx, and BX that provides outbound options routing from each to other market centers, subject to certain conditions. The Commission is approving today ISE’s proposal that NES operate as a facility of ISE that provides outbound options routing to other market centers, subject to similar conditions. The operation of NES as a facility of each of the Affiliated Exchanges providing outbound routing

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22 See ISE Gemini Notice, supra note 5, at 96137; ISE Mercury Notice, supra note 5, at 96090. See also infra Sections III.B–C.
23 See ISE Gemini Notice, supra note 5, at 96137; ISE Mercury Notice, supra note 5, at 96090.
24 See infra ISE Mercury Notice, supra note 5, at 96090.
services will be subject to oversight by ISE, Nasdaq, BX, and Phlx, respectively, as well as Commission oversight. Each of the Affiliated Exchanges will be responsible for ensuring that NES’s outbound options routing services are operated consistent with Section 6 of the Act and with the respective Affiliated Exchange’s rules. In addition, the Affiliated Exchanges must each file with the Commission rule changes and fees relating to their outbound options routing services provided by NES.

Recognizing that the Commission previously expressed concern 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 interest, ISE Gemini and ISE Mercury proposed the following limitations and conditions to permit each Exchange to accept inbound options orders that NES routes in its capacity as a facility of the Affiliated Exchanges:30 Pursuant to the RSA, each Exchange and the Financial Industry Regulatory Authority (“FINRA”) will maintain a Regulatory Services Agreement (“RSA”), as well as an agreement pursuant to Rule 17d-2 under the Act (“17d-2 Agreement”).31 Pursuant to the RSA and the 17d-2 Agreement, FINRA will be allocated regulatory responsibilities to review NES’s compliance with certain Exchange rules.32 Pursuant to the RSA, however, each Exchange retains ultimate responsibility for enforcing its rules with respect to NES.

• Second, FINRA will monitor NES for compliance with each of the Exchange’s trading rules, and will collect and maintain certain related information.33

• Third, FINRA will provide a report to each 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 the respective Exchange’s, rules, and (ii) lists all investigations that identify NES as a participant that has potentially violated Commission, or the respective Exchange’s, rules.

• Fourth, ISE Gemini and ISE Mercury proposed to amend ISE Gemini Rule 309 and ISE Mercury Rule 309, respectively, to add ISE Gemini Rule 309(b) and ISE Mercury Rule 309(b), which will provide that Nasdaq, Inc., as the holding company owning both the Exchange and NES, shall 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 the Exchange’s systems 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 routing to the Exchange.34

The Commission finds that ISE Gemini and ISE Mercury’s proposed rule changes to permit each Exchange to accept inbound options orders routed by NES from its Affiliated Exchanges, including the related change to ISE Gemini Rule 309 and ISE Mercury Rule 309, are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposed rule changes are consistent with Section 6(b)(1) of the Act,35 and Section 6(b)(5) of the Act.36

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest and the potential for unfair competitive advantage.37 Although the Commission continues to be concerned about potential unfair competition and conflicts of interest between an exchange’s self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit NES, in its capacity as a facility of each of the Affiliated Exchanges, to route options orders inbound to ISE Gemini and ISE Mercury, subject to the limitations and conditions described above.38

The Commission believes that these limitations and conditions will mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that a non-affiliated SRO’s oversight of NES,39 combined with a non-affiliated SRO’s monitoring of NES’s compliance with each of the respective Exchange’s rules and quarterly reporting to the respective Exchange, will help to protect the independence of ISE Gemini and ISE Mercury’s regulatory responsibilities with respect to NES. The Commission also believes that proposed ISE Gemini Rule 309(b) and proposed ISE Mercury Rule 309(b) are designed to ensure that NES cannot use any information advantage it may have because of its affiliation with ISE Gemini or ISE Mercury.40

C. Outbound Routing, Cancellation of Orders, and Error Accounts

As discussed above, the Commission is today approving a proposed rule change by ISE that will amend certain provisions in Chapter 19 of ISE’s rulebook, which is incorporated by reference to, and will therefore also become, the rules of ISE Gemini and ISE Mercury.41 Specifically, these new rules incorporated by reference will (1) permit ISE Gemini and ISE Mercury to route outbound orders in options listed and open for trading on their respective systems to away markets through NES, either directly or through a third-party routing broker-dealer; and (2) govern cancellation of orders by the Exchange or NES as either deems necessary to maintain a fair and orderly market if a technical or systems issue occurs at the Exchange, NES, or a routing destination, and the maintenance of an error account by NES for the purpose of addressing error positions that result from a
ISE Gemini and ISE Mercury each proposed that NES be permitted to perform the same functions pursuant to the same conditions with respect to the outbound routing of orders, cancellation of orders, and the handling of error positions as set forth in the ISE proposal.44 As discussed in the ISE Exchange Routing Order, the Commission believes that the proposed rules and procedures regarding the Exchanges’ use of NES to route orders to away markets, cancellation of orders, and handling of error positions, which will also apply to ISE Gemini and ISE Mercury’s use of NES, are consistent with the Act, for the reasons, and pursuant to the protections and considerations, discussed in such order.45

In addition, the Exchanges propose to make a related, conforming rule change to ISE Gemini Rule 705 and ISE Mercury Rule 705, respectively, which do not incorporate by reference ISE’s rules. Currently, pursuant to ISE rules incorporated by reference, ISE Gemini and ISE Mercury utilize Linkage Handlers 46 unaffiliated with the Exchange to route outbound orders.47 Pursuant to the proposed rule change by ISE, as applied to the Exchanges, ISE Gemini and ISE Mercury will no longer utilize unaffiliated Linkage Handlers to route outbound orders and instead, NES will route orders to other options exchanges, either directly, or indirectly through unaffiliated third-party routing broker-dealers, on behalf of ISE Gemini and ISE Mercury.48 Accordingly, ISE Gemini and ISE Mercury have proposed to remove ISE Gemini Rule 705(d)(4) and ISE Mercury Rule 705(d)(4), respectively, which provide an exception to the limits on compensation in ISE Gemini Rule 705(d) and ISE Mercury Rule 705(d) for Members to the extent such Members are acting as Linkage Handlers.49 ISE Gemini and ISE Mercury explained that Phlx does not have a similar provision and ISE is also removing this provision from its comparable rule.50 The Commission believes that this minor, conforming revision is consistent with the Act.

IV. Implementation of Proposed Rule Change

ISE Gemini and ISE Mercury stated that they intend to begin implementation of the proposed rule changes in the first quarter of 2017 and third quarter of 2017, respectively, and that the migration will be on a symbol-by-symbol basis.51 The Commission expects that the Exchanges will issue alerts to Members to announce the relevant migration date for specific symbols. ISE Gemini and ISE Mercury represented that they will add notations in each rulebook to cross-reference the amended rule text and clarify the respective implementation dates.52

III. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,53 that the proposal is adopted subject to the following conditions, effective February 9, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.54

Eduardo A. Aleman,
Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing of Proposed Rule Change To Adopt New Equities Trading Rules To Transition Trading on the Exchange From a Floor Based Market With A Parity Allocation Model to Fully Automated Price-Time Priority Model on the Exchange’s New Trading Technology Platform, Pillar

February 9, 2017.

Pursuant to Section 19(b)(1)1 of the Securities Exchange Act of 1934 (the “Act”)2 and Rule 19b–4 thereunder,3 notice is hereby given that, on January 25, 2017, NYSE MKT LLC (the “Exchange” or “NYSE MKT”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes new rules to transition trading on the Exchange to Pillar, the Exchange’s new trading technology platform, and to operate as a fully-automated cash equities market. The proposed rule change is available on the Exchange’s Web site at www.nyse.com, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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 self-regulatory organization 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 parts of such statements.