

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78791; File No. SR-ISEMercury-2016-14]

### Self-Regulatory Organizations; ISE Mercury, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Add Specificity to the Definition of a Professional in the Exchange's Rules

September 8, 2016.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 30, 2016, ISE Mercury, LLC ("Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as 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 from interested persons.

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

The Exchange proposes to amend Exchange Rule 100(a)(37C) (Definitions) to add specificity to the definition of a Professional with respect to the manner in which the volume threshold will be calculated by the Exchange.

The text of the proposed rule change is available on the Exchange's Web site at [www.ise.com](http://www.ise.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 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 these 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 Exchange proposes to amend the definition of "Professional" in Rule 100(a)(37C) to specify the manner in which the Exchange calculates orders to determine if an order should be treated as Professional Order.

##### Background

Exchange Rule 100(a)(37C) currently states, that the term Professional Order means an order that is for the account of a person or entity that is not a Priority Customer. A Priority Customer means a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).<sup>3</sup> In order to properly represent orders entered on the Exchange, members are required to indicate whether orders are "Professional Orders." To comply with this requirement, members are required to review their Priority Customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker-dealer should be represented as Priority Customer Orders or Professional Orders.<sup>4</sup>

The Exchange accepts orders routed from other markets that are marked Professional Orders. The designation of Professional Order does not result in any different treatment of such orders for purposes of Exchange rules concerning away market protection. That is, all non-broker or dealer orders, including those that meet the definition of Professional Orders, are treated equally for purposes of Exchange away market protection rules.<sup>5</sup> The Exchange continues to believe that identifying Professional Orders based upon the average number of orders entered in

<sup>3</sup> Rule 100(a)(37A).

<sup>4</sup> Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional Orders for the next calendar quarter. Members will be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five days after the end of each calendar quarter. While Members only will be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as Priority Customer Orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the Member and the Member will be required to change the manner in which it is representing the customer's orders within five days.

<sup>5</sup> See International Securities Exchange, LLC Rules at 1901, 1902 and 1903, which are referenced in the Exchange's rules.

qualified accounts is an appropriately objective approach to reasonably distinguish such persons and entities from retail investors or market participants.

##### Proposal

The Exchange proposes to count each Professional Order, regardless of the options exchange to which the order was routed in determining Professional Orders.<sup>6</sup>

##### Cancel and Replace

A cancel and replace order is a type of order that replaces a prior order. The Exchange believes that the second order (the replacement order) should be counted as a new order. With respect to "single-strike algorithms," which are a series of cancel and replace orders in an individual strike which track the Best Bid and Offer ("BBO") or National Best Bid and Offer ("NBBO"), these orders shall be counted as new orders.<sup>7</sup> The Exchange believes that because the Priority Customer is specifically instructing the executing broker in the "single-strike algorithm" scenario to cancel and replace these orders, that this type of activity is akin to market making in a Priority Customer account and should be counted, as a new order.

##### Parent/Child Orders

An order that converts into multiple subordinate orders to achieve an execution strategy shall be counted as one order per side and series, even if the order is routed away.<sup>8</sup> An order that cancels and replaces a resulting subordinate order and results in multiple sides/series shall be counted as a new order on each side and series. For purposes of counting Professional Orders, the manner in which the Priority Customer submitted the order and whether the order was on the same side and series will determine if the order will count as one order. If one Priority Customer order on the same side and series is subsequently broken-up by a broker into multiple orders for purposes of execution or routed away, this order will count as one order. The Exchange believes that the proposed amendment will provide more certainty to market participants in determining the manner in which the Exchange will compute the number of orders in listed

<sup>6</sup> All order types count toward the 390 orders on average per day.

<sup>7</sup> Cancel messages do not count as an order.

<sup>8</sup> An order which is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple parts by a broker or dealer or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer. Strategies include volatility orders, for example.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

options per day on average during a calendar month for its own beneficial account(s) to determine the Professional Order designation.

In order to make clear when orders will count as new orders, the Exchange offers the following scenarios as examples.

- The Exchange proposes to count multiple orders that were submitted by the member as separate orders as multiple orders.

- The Exchange proposes to count a single order submitted by a member, which was automatically executed in multiple parts by the trading system, as one order, because the member did not intervene to create multiple orders.

Another example is where an order was entered in the trading system and only partially filled, the order would count as one order. The subsequent fills, which could be multiple executions, would not count as additional orders in determining the 390 limit. The manner in which the order is ultimately executed, as one order or multiple orders, should not itself determine whether the activity qualified as a Professional Order; also the member did not intervene in that circumstance.

- The Exchange proposes to count orders, which result in multiple orders due to cancel and replacement orders,

as new orders. This is because in this situation the member did intervene to create the subsequent orders.

- The Exchange proposes to count an order submitted by the Priority Customer as a single order, on the same side and series, as a single order despite the fact that a broker broke-up the order into multiple orders for purposes of execution.

The Exchange previously issued a notice which described the manner in which it believed thresholds should be computed for determining if an order qualifies as a Professional Order.<sup>9</sup> This rule supersedes the Exchange's notice.

The Exchange believes that there has been industry confusion as to which orders count toward the 390 contract threshold. The Exchange's proposal is intended to provide clarity and to continue to promote consistency in the treatment of orders as Professional Orders by filing a rule change similar to other options exchanges.<sup>10</sup>

Below are some examples of the calculation of Professional Orders.

**Example #1**

A Priority Customer has an order to buy 100 calls at a volatility level of 35. The order then generates a child order resulting in a 1.00 bid for 100 options which is sent to Exchange A. After the underlying stock price ticks up 2 cents

the child order is then adjusted to reflect a 35 level volatility which in this case (50 delta) results in a 1.01 bid sent to Exchange A replacing the current 1.00 bid.

In determining the number of orders that attribute to the 390 order count, in this case, because the child order is being canceled and replaced in the "same series" this would only count as one (1) order for purposes of Professional designation calculation.

**Example #2**

A Priority Customer has an order to buy 20k Vega at a 35 volatility level in symbol XYZ. The order then generates 50 child orders across different strikes. Throughout the day those 50 orders are adjusted as the stock moves resulting in the replacement of child orders to the tune of 5 times per order (50 x 5 cancels) resulting in 250 total orders generated to Exchange A.

In determining the number of orders that attribute to the 390 order count, in this case, because the child orders generated are across multiple series it would be necessary to count all 250 orders.

In addition to the above examples, the Exchange provides the below chart to demonstrate the manner in which it will count orders.

	Singular	Multiple
<b>Single Strike Activity</b>		
Priority Customer Order posted to 1 SRO order Book .....	x	.....
Priority Customer Order posted to Multiple SRO order Books simultaneously .....	x	.....
Cancel/Replace Activity .....	x	.....
Cancel/Replace Activity tracking BBO or NBBO .....	.....	x

Singular—counts as a single order towards the 390 count.  
Multiple—each order applies towards the 390 count.

The Exchange proposes to implement this rule on October 3, 2016 to provide market participants with advance notice for their quarterly calculations. The Exchange will issue a Market Information Circular in advance to inform market participants of such date.

**2. Statutory Basis**

The Exchange believes that its proposal is consistent with section 6(b) of the Act,<sup>11</sup> in general, and furthers the objectives of section 6(b)(5) of the Act,<sup>12</sup> 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, by promoting the consistent application of its rules by further defining the manner in which the Exchange will compute the number of orders in listed options per day on average during a calendar month for its own beneficial account(s) for purposes of determining the Professional Order designation. Furthermore, the Exchange believes that specifying the manner in which the 390 threshold will be calculated within its Rules will provide members with certainty and provide them with insight as they conduct their own quarterly

reviews for purposes of designating orders.

The Exchange believes that counting all orders toward the number of orders, regardless of the options exchange to which the order was routed, will promote the consistent application of its rules by making clear that all order types shall be counted as well as all orders for the purpose of determining whether the definition of Professional Order has been met.

**Cancel and Replace**

With respect to determining the Professional Order designation, a cancel and replace order which replaces a prior

<sup>9</sup> See International Securities Exchange LLC's Regulatory Information Circular (2009-179) dated June 23, 2009.

<sup>10</sup> NASDAQ BX, Inc. and NASDAQ Options Market LLC have similar rules in place for computing Professional orders. See BX Rules at

chapter I, section 1(49). See NOM Rules at chapter I, section 1(48).

<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

order shall be counted as a second order. An order that is filled partially or in its entirety or is a replacement order that is automatically canceled or reduced by the number of contracts that were executed will not count as second order because it was not replaced. The Exchange believes that counting the replacement order as a second order is consistent with Exchange Rules because the replacement order is viewed as a new order with its own unique identifier.

The Exchange believes that counting cancel and replace orders with “single-strike algorithms,” which are a series of cancel and replace orders in an individual strike which track the BBO or NBBO, as new orders is consistent with the Act because the Priority Customer is specifically instructing the executing broker in the “single-strike algorithm” scenario to cancel and replace these orders. Tracking the BBO or NBBO<sup>13</sup> is akin to market making on the Exchange in a Priority Customer account and should be counted as new orders. The Exchange believes that the Priority Customers order designation should be reserved for a Priority Customer.

#### Parent/Child Orders

The Exchange’s adoption of the Professional Order was to treat orders in listed options per day on average during a calendar month in his or her own beneficial account differently from Priority Customer Orders for purposes of priority within the order book and pricing.<sup>14</sup> For this reason, the Exchange is adopting rules concerning the computation of orders which convert into multiple subordinate orders for the purpose of determining the Professional Order designation. The Exchange’s proposal to count multiple subordinate orders that achieve an execution strategy as one order per side and series and count an order that cancels and replaces a resulting subordinate order and results in multiple sides/series as a new order is consistent with the Act, because the Exchange is distinguishing where the member is actively entering orders that result in multiple orders and canceling and replacing orders that result in multiple orders versus where the member had no control of the resulting executions. Allowing orders on the same side of the market to be

counted as a single order is consistent with the original intent of the Professional Order designation. The same side of market distinction protects Priority Customers. This practice is typically the type of transaction Priority Customers execute versus a Professional trader. Multiple related orders resulting from a large order filled in part, or an order which is cancelled and replaced several times are considered part of a related order. The Exchange does not desire to count large orders filled in part as multiple orders because the member did not intervene in the outcome of the execution. An order that results in several separate and unrelated orders would be counted as multiple orders because the member intervened in this circumstance.

The Exchange believes that the proposed amendment will provide more certainty to market participants in determining the computation of the number of orders in listed options per day on average during a calendar month for its own beneficial account(s) to determine the Professional Order designation. The Exchange believes that there is confusion as to which orders count toward the 390 contract threshold. The Exchange proposes to provide clarity to its Rules with specific guidance as to the computation of Professional Orders, which it believes will promote consistency in the treatment of orders as Professional orders. The Exchange believes that this proposed guidance will promote consistency and permit the proper calculation of options orders to prevent members with high volume from receiving benefits reserved for Priority Customer Orders. The Professional Order designation focuses specifically on the number of orders generated.

Priority is one of the marketplace advantages provided to Priority Customer orders on the Exchange. Priority Customer orders are given execution priority over non-Customer orders and quotations of market makers at the same price. Another marketplace advantage afforded to Priority Customer Orders on the Exchange is that members are generally not assessed transaction fees for the execution of Priority Customer Orders. The purpose of these marketplace advantages is to attract retail order flow to the Exchange by leveling the playing field for retail investors over market Professionals.<sup>15</sup>

<sup>15</sup> Market Professionals have access to sophisticated trading systems that contain functionality not available to retail customers, including things such as continuously updated pricing models based upon real-time streaming data, access to multiple markets simultaneously and order and risk management tools.

The Exchange believes that permitting certain types of orders to be counted as a single order and other types of orders to be counted as multiple orders is consistent with the original intent of the Professional Order designation which was to continue to provide Priority Customer accounts with marketplace advantages and distinguish those accounts non-Professional retail investors from the Professionals accounts some non-broker-dealer individuals and entities have access to information and technology that enables them to Professionally trade listed options in the same manner as a broker or dealer in securities.<sup>16</sup>

Finally, the proposed guidance is being issued to stem confusion as to the manner in which options exchanges compute the Professional Order volume.

#### *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 because the Exchange will uniformly apply the rules to calculate volume on all members in determining Professional Orders. The designation of Professional Orders would not result in any different treatment of such orders for purposes of the Exchange’s Rules concerning order protection or routing to away exchanges. The guidance is being issued to stem confusion as to the manner in which options exchanges compute the Professional Order volume.

#### Counting All Orders

The Exchange believes that counting all orders entered by a Professional toward the number of orders, regardless of the options exchange to which the order was routed, does not create an undue burden on intra-market competition because this proposed rule change will be consistently applied to all members in determining Professional Orders.

#### Cancel and Replace

The Exchange believes that its application of cancel and replace orders does not create an undue burden on intra-market competition because this application is consistent with Exchange Rules, where the replacement order is

<sup>16</sup> For example, some broker-dealers provided their Professional customers with multi-screened trading stations equipped with trading technology that allows the trader to monitor and place orders on all six options exchanges simultaneously. These trading stations also provide compliance filters, order managements tools, the ability to place orders in the underlying securities, and market data feeds.

<sup>13</sup> Tracking the BBO or NBBO shall mean any parent order that consumes any self-regulatory organization order book data feed, or the OPRA feed, to generate automated child orders, and move with, or follow the Bid or Offer of the series in question.

<sup>14</sup> See Exchange Rule 713 and the Exchange’s Fee Schedule.

viewed as a new order. This treatment is consistent with the manner in which this order type is applied today within the order Book.

#### Parent/Child Orders

The Exchange's treatment of subordinate orders does not create an undue burden on intra-market competition because allowing orders on the same side of the market to be counted as a single order is consistent with the original intent of the Professional Order designation which is to count distinct orders and focus on the number of orders generated.

The Exchange does not believe that the proposed rule change will impose an undue burden on inter-market competition because other exchanges have adopted similar guidance.<sup>17</sup> The Exchange believes that disparate rules regarding Professional Order designation, and a lack of uniform application of such rules, does not promote the best regulation and may, in fact, encourage regulatory arbitrage. The Exchange believes that it is therefore prudent and necessary to conform its rules to that of other options exchanges for purposes of calculating the threshold volume of orders to be designated as a Professional Order. This is particularly true where the Exchange's third-party routing broker-dealers are members of several exchanges that have rules requiring Professional Order designations.

#### 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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to section 19(b)(3)(A)(iii) of the Act<sup>18</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>19</sup>

<sup>17</sup> NASDAQ BX, Inc. and NASDAQ Options Market LLC have similar rules in place for computing Professional orders. See BX Rules at chapter I, section 1(49). See NOM Rules at chapter I, section 1(48).

<sup>18</sup> 15 U.S.C. 78s(b)(3)(a)(iii).

<sup>19</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) Necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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 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](mailto:rule-comments@sec.gov). Please include File No. SR-ISEMercury-2016-14 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 No. SR-ISEMercury-2016-14. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of

the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-ISEMercury-2016-14, and should be submitted on or before October 5, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

**Brent J. Fields,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-78788; File No. SR-ISE-2016-19]

### Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Add Specificity to the Definition of a Professional in the Exchange's Rules

September 8, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on August 30, 2016, the International Securities Exchange, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as 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 from interested persons.

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

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The text of the proposed rule change is available on the Exchange's Web site at [www.ise.com](http://www.ise.com), at the principal office

<sup>20</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.