

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.²¹

- 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 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.²²

- Fourth, the Exchange has adopted BX Equity Rule 2140(c), which requires NASDAQ OMX, as the holding company owning both the Exchange and NES, to 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 order routing to the Exchange.²³

- Fifth, routing of orders from NES to the Exchange, in NES's capacity as a facility of Nasdaq, was authorized for a pilot period of twelve months.²⁴

The Exchange believes that by meeting the above-listed conditions it has set up mechanisms that 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.²⁵

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.²⁶ 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 to provide inbound routing to the Exchange on a permanent basis instead of a pilot basis, subject to the other conditions described above.

The Exchange has proposed four ongoing conditions applicable to NES's routing activities, which are enumerated above. The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that FINRA's oversight of NES,²⁷ combined with FINRA's monitoring of NES's compliance with the equity trading rules and quarterly reporting to the Exchange's CRO, will help to protect the independence of the Exchange's regulatory responsibilities with respect to NES. The Commission also believes that BX Equity Rule 2140(c) is designed to ensure that NES cannot use any information advantage it may have because of its affiliation with the Exchange.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁸ that the proposed rule change (SR-BX-2011-007) be, and hereby is, approved.

²⁶ See, e.g., Securities Exchange Act Release Nos. 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (SR-NASDAQ-2006-006) (order approving Nasdaq's proposal to adopt Nasdaq Rule 2140, restricting affiliations between Nasdaq and its members); 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving the combination of the New York Stock Exchange, Inc. and Archipelago Holdings, Inc.); 58673 (September 29, 2008), 73 FR 57707 (October 8, 2008) (SR-Amex-2008-62) (order approving the combination of NYSE Euronext and the American Stock Exchange LLC); 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (SR-ISE-2009-85) (order approving the purchase by ISE Holdings of an ownership interest in DirectEdge Holdings LLC); and 59281 (January 22, 2009), 74 FR 5014 (January 28, 2009) (SR-NYSE-2008-120) (order approving a joint venture between NYSE and BIDS Holdings L.P.).

²⁷ This oversight will be accomplished through the 17d-2 Agreement between FINRA and the Exchange and the Regulatory Contract.

²⁸ 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁹

Cathy H. Ahn,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-64091; File No. SR-ISE-2011-04]

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Approving a Proposed Rule Change To Establish New Classes of Market Makers for Index Options

March 17, 2011.

I. Introduction

On January 12, 2011, the International Securities Exchange, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules to establish two new classes of market makers for index options traded on the Exchange. The proposed rule change was published for comment in the **Federal Register** on January 31, 2011.³ The Commission received no comments regarding the proposal. This order approves the proposed rule change.

II. Description of the Proposal

The Exchange proposed to amend its rules to establish the following new classes of market makers for certain index options traded on the Exchange: Index Options Primary Market Makers ("IXPMM")⁴ and Index Options Competitive Market Makers ("IXCMM"),⁵ collectively referred to as IXMMs.

The Exchange's proposal to separate out and introduce a new class of market maker trading licenses that are specific to index options is intended to allow an opportunity for additional market

²⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 63761 (January 25, 2011), 76 FR 5412 ("Notice").

⁴ An IXPMM is defined in new ISE Rule 2013(a) as a primary market maker in Eligible Index Options traded on the Exchange pursuant to new ISE Rule 2013.

⁵ An IXCMM is defined in new ISE Rule 2013(a) as a competitive market maker in Eligible Index Options traded on the Exchange pursuant to new ISE Rule 2013.

²¹ Pursuant to the Regulatory Contract, both FINRA and the Exchange will collect and maintain all alerts, complaints, investigations and enforcement actions in which NES (in its capacity as a facility of Nasdaq routing orders to the Exchange) is identified as a participant that has potentially violated applicable Commission or Exchange rules. The Exchange and FINRA will retain these records in an easily accessible manner in order to facilitate any potential review conducted by the Commission's Office of Compliance Inspections and Examinations. See Notice, *supra* note 3, 76 FR at 8391, n.10.

²² See Notice, *supra* note 3, 76 FR at 8392.

²³ See BX Equity Rule 2140(c). See also Notice, *supra* note 3, 76 FR at 8392.

²⁴ See Notice, *supra* note 3, 76 FR at 8392. The Commission notes that the original pilot period of twelve months was approved and began on December 23, 2008, but was extended several times. See Notice, *supra* note 3, 76 FR at 8391, n.6 and accompanying text.

²⁵ See Notice, *supra* note 3, 76 FR at 8392.

participants, who are not currently maker makers on the Exchange's First Market, to trade new index options as index-specific market makers.⁶

Because the Exchange's proposal primarily focuses on newly-listed index products, the proposal describes how the existing 28 cash-settled indexes traded on the Exchange will be treated. Specifically, index options listed on the Exchange prior to December 31, 2010 ("Legacy Index Options") already have a PMM assigned. The proposal does not affect those assignments, and such PMMs will simply continue to function as PMMs (*i.e.*, as an IXPMM) in its currently-assigned index option(s). In addition, except as provided above, the proposal provides that all current and future First Market PMMs and CMMs may trade (as an IXCMM) all existing and future index products, including both Legacy Index Options and Eligible Index Options without having to purchase a separate IXCMM trading license. Market participants that are not currently a PMM or CMM on the Exchange's First Market will be required to purchase a new IXCMM license in order to trade in index options on the Exchange.⁷

Eligible Index Options. New ISE Rule 2013(c) defines "Eligible Index Options" as: (i) Index options that have a 6-month average daily volume of less than 10,000 contracts in the US market; and (ii) index options that have a trading history of less than 6 months, in which case the eligibility threshold would be prorated proportionately over the time that an index was listed in the US market.⁸ Prior to the listing of an Eligible Index Option, the Exchange will conduct a one-time eligibility test to determine whether an index product is an Eligible Index Option. The Exchange will conduct the eligibility test when an index product is qualified for listing under ISE rules and prior to its certification with the Options Clearing Corporation.⁹ The following index products are *not* Eligible Index Options: Russell 2000 Index ("RUT"), the NASDAQ-100 Index ("NDX"), and the Mini-NASDAQ-100 Index ("MNX").¹⁰

⁶ See Notice, *supra* note 3, 76 FR at 5412. An IXCMM license, by itself, would not allow the holder thereof to trade in equity or ETF options traded on the Exchange.

⁷ IXCMM trading licenses will not represent ownership of any equity interest in the Exchange.

⁸ For example, if an index has a trading history for just three months in the US market, the prorated eligibility threshold applied by ISE would be 20,000 ADV.

⁹ The Exchange currently follows this process with regards to the listing of all equity (including ETF) and index option products traded on the Exchange.

¹⁰ See new ISE Rule 2013(c)(2).

Legacy Index Options. ISE defines Legacy Index Options as index options listed on the Exchange prior to December 31, 2010.¹¹ New ISE Rule 2013(c)(3) provides that the current First Market PMM that has an allocation as PMM in a particular Legacy Index Option will be deemed to be the IXPMM for Legacy Index Options and, accordingly, will not need to purchase an IXPMM license to continue to trade as an IXPMM in that Legacy Index Option. In the event a Legacy Index Option is de-listed and subsequently re-listed, ISE will allocate the IXPMM license for that index through the auction process described in Rule 2013.¹²

There will be one IXPMM per each Eligible Index Option and Legacy Index Option.¹³ IXPMM trading licenses shall be permanently granted as long as the IXPMM meets its stated market quality commitments.¹⁴ By contrast, all IXCMM trading licenses will be for a term of one year.

Allocations Generally. Traditionally, new index products on the Exchange have been allocated as part of the general allocation to ISE's "First Market," which is the general market for higher-volume equity, ETF and index options. The Exchange states that it will offer IXCMM trading licenses in a manner similar to how it offers foreign currency ("FX") options trading licenses to FX market makers.¹⁵ IXPMM allocations will be based on the same methodology ISE currently uses for FXPMs in its FX products, which is based, in part, on market quality commitments.

IXPMM Allocations for Eligible Index Options. Current and future First Market

¹¹ As of December 31, 2010, the following indexes are Legacy Index Options: Mini FTSE 100 (symbol, UKX); ISE Semiconductors (BYT); ISE Electronic Trading (DMA); ISE-Revere Natural Gas (FUM); ISE Water (HHO); ISE Homeland Security (HSX); ISE Long Gold (HVV); ISE 250 (IXZ); ISE U.S. Regional Banks (JLO); ISE Oil and Gas Services (OOG); ISE Integrated Oil and Gas (PMP); ISE Bio-Pharmaceuticals (RND); ISE Homebuilders (RUF); ISE SINdex (SIN); ISE Nanotechnology (TNY); ISE Revere Wal-Mart Supplier (WMX); KBW Bank Index (BKK); KBW Mortgage Finance Index (MFX); Morgan Stanley Technology Index (MSH); Morgan Stanley Retail Index (MVR); Nasdaq Q-50 Index (NXTQ); Mini-Russell 2000 (RMN); Russell 1000 Index (RUI); S&P Mid Cap 400 Index (MID); Standard & Poor's Small Cap 600 Index (SML).

¹² In other words, the delisting of a Legacy Index Option terminates its status as a Legacy Index Option for purposes of new ISE Rule 2013.

¹³ See new ISE Rule 2013(c)(3) and (e)(1).

¹⁴ See new ISE Rule 2013(e)(1). The Board or designated committee, however, may suspend or terminate any trading license of a market maker whenever, in the Board's or designated committee's judgment, the interests of a fair and orderly market are best served by such action. See new ISE Rule 2013(e)(1).

¹⁵ See Securities Exchange Act Release No. 55575 (April 3, 2007), 72 FR 17963, 17964 (April 10, 2007) (SR-ISE-2006-59).

PMMs/CMMs may acquire an IXPMM trading license by participating in an auction, which involves the submission of a monetary bid and market quality commitments.

IXPMM trading licenses will be sold by means of a sealed bid auction conducted by the Exchange. A separate auction would be conducted for each index option for which ISE seeks to allocate an IXPMM. The "winning" bid at which an IXPMM trading license is sold is referred to as the "Auction Price." Together with its bid, a member seeking an IXPMM trading license must provide, at a minimum, market quality commitments regarding: (1) The average quotation size it will disseminate in an Eligible Index Option; and (2) the maximum quotation spread it will disseminate in such product at least 90% of the time. At the end of the auction, the Exchange will determine the winning bidder for an IXPMM trading license based on bid amount and market quality commitment, and may reject a bid if the Exchange deems a market quality commitment to be unrealistic or significantly inferior to market quality commitments submitted by other bidding members. In an auction for a trading right for an Eligible Index Option, ISE will give preferred consideration to a First Market PMM/CMM where bid and quality commitments are equal to those submitted by a new member who is not a First Market PMM/CMM.

Once allocated, the IXPMM may change its market quality commitment only to the extent that the new commitments are an improvement to its existing commitment. Under new Rule 2013(e)(4), the Exchange will review and assess market quality commitments on a quarterly basis to ensure IXPMMs are in compliance with their stated commitments. At the discretion of the Exchange and subject to the procedural protections provided under the rules of the Exchange,¹⁶ failure to meet stated commitments may result in ISE terminating an allocation and conducting an auction to reallocate the failing IXPMM's index option.¹⁷

IXCMM Allocations. Current and future First Market PMMs may request, and if requested will be allocated, an IXCMM trading license without having to pay any additional fee. A member who is not a First Market PMM/CMM will be required to purchase an IXCMM trading license to trade as an IXCMM on the Exchange. IXCMM trading licenses will be available for purchase at any

¹⁶ See Chapter 17 of ISE Rules.

¹⁷ See *supra* note 14.

time during a calendar year.¹⁸ All IXCMM trading licenses will expire at the end of the calendar year in which they are issued but, upon request by a PMM or CMM, will be renewed for subsequent years on an annual basis.¹⁹

IXMM Duties and Privileges. By amending ISE Rule 802(b) to permit the allocation of Eligible Index Options, subject to new Rule 2013, ISE is subjecting market makers in Eligible Index Options to the obligations imposed on Exchange market makers under Chapter 8 of the Exchange's rules. Accordingly, once an IXPMM obtains a trading license in an Eligible Index Option, the IXPMM will have all of the responsibilities and privileges of a PMM under the Exchange's rules.²⁰ Similarly, once an IXCMM obtains a trading license in an Eligible Index Option, the IXCMM will have all the responsibilities and privileges under the Exchange's rules.

After an IXPMM has purchased a trading license, the IXPMM may terminate its status as IXPMM in an index option if the IXPMM is unable to meet its obligations, provided the IXPMM gives at least 60 days prior written notice to the Exchange of such termination. In the event the Exchange is unable to re-allocate the IXPMM's index option product within the notice period and the index option product is *singly listed* on ISE, then the IXPMM will be required to continue to fulfill its obligations in that product until all open interest has been closed. An IXCMM may terminate its trading license prior to its scheduled expiration by providing at least 10 days prior written notice to the Exchange.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,²¹ which requires, among other things, that the rules of a national securities exchange be 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.

The Commission believes that the provisions governing the two new classes of market makers that will be permitted to trade Eligible Index Options and Legacy Index Options on the Exchange, IXPMMs and IXCMMs, are consistent with the Act. The Commission notes that IXPMMs and IXCMMs will be subject to identical obligations that correspond to the market making obligations applicable to First Market PMMs and CMMs, respectively.²² The Commission notes that, to obtain a trading license, IXPMMs will be required to provide the Exchange with market quality commitments²³ and, if an IXPMM continuously fails to meet its stated market quality commitments, the Exchange may terminate its IXPMM allocation.²⁴

The Commission believes that the procedures under which the Exchange proposes to offer IXMM licenses are reasonably designed to award such allocations in a fair and reasonable manner. In particular, the Commission believes that provisions governing IXCMM trading licenses are designed to ensure that market maker trading licenses will be widely available because the Exchange will make an unlimited amount of IXCMM licenses available for purchase by members who are not PMMs or CMMs on the Exchange's First Market.²⁵ In addition, the requirement that bidders provide market quality commitment in addition to their bid for an IXPMM allocation will allow the Exchange to grant IXPMM trading licenses in an objective manner without awarding a trading license solely based on the highest bid.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁶ that the proposed rule change (SR-ISE-2011-04) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁷

Cathy H. Ahn,

Deputy Secretary.

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²² See *supra* note 20.

²³ See new ISE Rule 2013(e)(3).

²⁴ See new ISE Rule 2013(e)(4).

²⁵ See new ISE Rule 2013(f).

²⁶ 15 U.S.C. 78s(b)(2).

²⁷ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-64095; File No. SR-EDGX-2011-06]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by EDGX Exchange, Inc. To Delete the Description of and All References to Step-Up Orders in EDGX Rules

March 18, 2011.

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 March 10, 2011, EDGX Exchange, Inc. ("EDGX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II 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, and is approving the proposal on an accelerated basis.

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

The Exchange proposes to amend its Rules 11.5(c)(11) and Rule 11.9(b)(1)(C) to delete the description of and all references to Step-Up orders. The text of the proposed rule change is attached as Exhibit 5 and is available on the Exchange's Web site at <http://www.directedge.com>, at the Exchange's principal office, and at the Public Reference Room of the Commission.

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 self-regulatory organization has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

¹⁸ IXCMM trading licenses sold during a calendar year will be prorated to reflect the number of trading days in the year. See new ISE Rule 2013(f)(2).

¹⁹ See Notice, *supra* note 3, 76 FR at 5414.

²⁰ For example, IXPMMs will enjoy privileges that include, among other things, participation rights and small order execution preference while accepting responsibilities that include, among other things, the obligation to provide continuous quotations in an Eligible Index Option for which it has been allocated, to conducting the opening rotation on a daily basis for as long as the IXPMM retains an allocation in an Eligible Index Option.

²¹ 15 U.S.C. 78f(b)(5). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).