

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68760; File No. SR-ISE-2013-05)

January 29, 2013

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Certain Market Maker Fees

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 17, 2013, the International Securities Exchange, LLC (the "Exchange" or the "ISE") filed with the Securities and Exchange 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 the Substance of the Proposed Rule Change

The ISE proposes to amend its Schedule of Fees. The text of the proposed rule change is available on the Exchange's website (<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 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 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.

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

1. Purpose

The Exchange currently assesses per contract transaction fees and provides rebates to market participants that add or remove liquidity from the Exchange (“maker/taker fees and rebates”) in a number of options classes (the “Select Symbols”).³ The Exchange’s maker/taker fees and rebates are applicable to regular and complex orders executed in the Select Symbols. The Exchange also currently assesses maker/taker fees and rebates for complex orders in symbols that are in the Penny Pilot program but are not a Select Symbol (“Non-Select Penny Pilot Symbols”)⁴ and for complex orders in all symbols that are not in the Penny Pilot Program (“Non-Penny Pilot Symbols”).⁵

The purpose of this proposed rule change is to increase the discount for Market Makers⁶ when they trade against Priority Customer⁷ orders that are preferenced to them to \$0.05 per contract from the fee charged to Market Makers who trade against Priority Customer orders that are not preferenced to them. This discount is currently set at \$0.02 per contract and is applicable

³ Options classes subject to maker/taker fees and rebates are identified by their ticker symbol on the Exchange’s Schedule of Fees.

⁴ See Exchange Act Release Nos. 65724 (November 10, 2011), 76 FR 71413 (November 17, 2011) (SR-ISE-2011-72); and 66961 (May 10, 2012), 77 FR 28914 (May 16, 2012) (SR-ISE-2012-38).

⁵ See Exchange Act Release Nos. 66084 (January 3, 2012), 77 FR 1103 (January 9, 2012) (SR-ISE-2011-84); 66392 (February 14, 2012), 77 FR 10016 (February 21, 2012) (SR-ISE-2012-06); 66961 (May 10, 2012), 77 FR 28914 (May 16, 2012) (SR-ISE-2012-38); and 67400 (July 11, 2012), 77 FR 42036 (July 17, 2012) (SR-ISE-2012-63).

⁶ The term “Market Makers” refers to “Competitive Market Makers” and “Primary Market Makers” collectively. See ISE Rule 100(a)(25).

⁷ A Priority Customer is defined in ISE Rule 100(a)(37A) as a person or entity that is not a broker/dealer in securities, and does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).

when Market Makers add or remove liquidity in the Select Symbols (excluding SPY), in SPY, in the Non-Select Penny Pilot Symbols and in the Non-Penny Pilot Symbols from the complex order book.⁸ Accordingly, Market Makers that add or remove liquidity from the complex order book by trading against Priority Customer complex orders that are preferenced to them will be charged: (i) \$0.34 per contract in the Select Symbols (including SPY) and in the Non-Select Penny Pilot Symbols; and (ii) \$0.77 per contract in the Non-Penny Pilot Symbols.

The Exchange notes that NASDAQ OMX PHLX, Inc. (“PHLX”) currently has a \$0.05 per contract differential between the fee it charges market makers for complex orders in certain symbols and the fee it charges directed (i.e., preferenced) market makers for the same transactions.⁹ With this proposed rule change, ISE seeks to adopt the \$0.05 differential currently in place at PHLX.

The Exchange notes that the fee differential currently between Market Makers and preferenced Market Makers on ISE is \$0.02 per contract where a preferenced Market Maker is assessed the lower fee. The Exchange is now proposing to increase the differential from \$0.02 per contract to \$0.05 per contract for complex order transactions to reflect the increased costs that are incurred by such Market Makers that enter into order flow arrangements at a cost and

⁸ The current \$0.02 per contract discount also applies to a group of symbols in which Market Makers can enter quotes in the complex order book (“Complex Quoting Symbols”). The discount applicable to the Complex Quoting Symbols is found on the Exchange’s Schedule of Fees. See Section II. Complex Order Fees and Rebates, footnote 4. This proposed rule change also applies to the Complex Quoting Symbols.

⁹ See Section I, Rebates and Fees for Adding and Removing Liquidity in Select Symbols, Part B. Complex Order at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLXTools/PlatformViewer.asp?selectednode=chp%5F1%5F4&manual=%2Fnasdaqomxphlx%2Fphlx%2Fphlx%2Drulesbrd%2F>. see also Securities Exchange Act Release No. 68202 (November 9, 2012), 77 FR 68856 (November 16, 2012) (the “PHLX Approval Order”).

without the benefit of a guaranteed allocation.¹⁰ The Exchange believes that in order to attract Priority Customer complex orders in an intensely competitive environment it must continue to adjust its fees and rebates, which ultimately benefit all market participants.

Market Makers may be categorized as preferred Market Makers when such Market Makers execute against a Priority Customer order preferred to them for execution by an order flow provider. For example, Market Maker ABCD is assessed the preferred Market Maker fee for trading against a Priority Customer order preferred to it for execution by an order flow provider. Market Maker ABCD is not assessed the discounted preferred Market Maker fee for executing a Priority Customer order that is not preferred to Market Maker ABCD, but rather is assessed the full Market Maker fee.

The Exchange notes that all Market Makers have the ability to incentivize an order flow provider to preference an order if they desire to enter into, for example, a payment for order flow arrangement with an order flow provider. While all market participants enjoy the benefits of the liquidity that such order flow brings to the market, not all market participants incur the additional expense of paying an order flow provider for such order flow. The Exchange believes that this additional expense should be considered in assessing fees to Market Makers that attract such order flow to the Exchange for the benefit of all market participants.

The Exchange proposes to implement this proposed rule change on a pilot basis set to expire one (1) year from the date the proposed fees become operative. In support of this

¹⁰ The Exchange notes that under ISE Rule 722(b)(3), the Exchange has the ability to provide Market Makers with a guaranteed allocation and the Exchange may do so by designating on a class basis where such guaranteed allocations would apply. The Exchange, however, has not designated any class as such. In the event the Exchange designates certain classes to provide Market Makers the benefit of a guaranteed allocation in those classes, the discount proposed in this filing will not apply to those preferred Market Makers in those classes of options designated by the Exchange.

proposed rule change, the Exchange agrees to submit to the Commission on a monthly basis during the pilot period certain summary data as the Commission may request regarding this proposed fee change and make this data publicly available. The data would include information with respect to rates of order interaction of Priority Customer complex orders and rates of price improvement, and an analysis of the effect of the fee differential upon inter-market and intra-market competition. In addition, the Exchange also agrees to submit data, and make it publicly available, on 1) the rate of interaction with preferenced Priority Customer complex orders by both preferenced Market Makers and non-preferenced Market Makers, 2) the rates of price improvement for preferenced Priority Customer complex orders that received price improvement by both preferenced Market Makers and non-preferenced Market Makers, and 3) the percentage of preferenced and non-preferenced Priority Customer complex orders that received price improvement, and the average price improvement for such orders, for the six months prior to the time that this proposed fee became operative (i.e., July 2012 through December 2012) to allow the Commission to analyze the impact of the proposed fee change.

The Exchange represents that the proposed fee change will apply only to equity options that are able to be listed and traded on more than one options exchange. There will be no discount for Singly Listed Symbols and FX Options Symbols.¹¹ The Exchange further represents that, prior to and at the time of a complex order transaction, Market Makers, including preferenced Market Makers, are unaware of the identity of the contra-party to the transaction and moreover, ISE Rule 400 titled “Just and Equitable Principles of Trade” is intended to prohibit

¹¹ Singly Listed Symbols and FX Options Symbols are identified by their ticker symbol on the Exchange’s Schedule of Fees. The Exchange is not providing this fee discount to Singly Listed Symbols and FX Options Symbols because these symbols are traded only on ISE and therefore, the Exchange does not need to provide an incentive to attract order flow in them.

coordinated actions between preferenced Market Makers and order flow providers, and that the Exchange proactively conducts surveillance for, and enforces against, such violations.

The Exchange also proposes to make one non-substantive amendment to the Exchange's Schedule of Fees. Specifically, the Exchange proposes to remove footnote 7 under Section I, Regular Order Fees and Rebates, as that footnote is no longer applicable. Footnote 7 was previously applicable to Special Non-Select Penny Pilot Symbols ("SNS Symbols"), a group of symbols that were a part of Section I of the Schedule of Fees. The Exchange recently removed the SNS Symbols from the Schedule of Fees in its entirety and moved them into the Select Symbols category.¹² The Exchange inadvertently failed to remove footnote 7 when it filed to remove the SNS Symbols and proposes to do so now.

The Exchange is not proposing any other changes in this filing.

2. Statutory Basis

The Exchange believes that its proposal to amend its Schedule of Fees is consistent with Section 6(b) of the Securities and Exchange Act of 1934 (the "Act")¹³ in general, and furthers the objectives of Section 6(b)(4) of the Act¹⁴ in particular, in that it is an equitable allocation of reasonable dues, fees and other charges among Exchange members and other persons using its facilities.

The Exchange believes that it is reasonable, equitable and not unfairly discriminatory to assess lower fees to preferenced market makers that add or remove liquidity from the complex order book by trading against Priority Customer orders that are preferenced to them in the Select

¹² See Securities Exchange Act Release No. 68240 (November 15, 2012), 77 FR 69905 (November 21, 2012) (SR-ISE-2012-88).

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(4).

Symbols (excluding SPY), in SPY, in the Non-Select Penny Pilot Symbols and in the Non-Penny Pilot Symbols, than the fee charged to Market Makers because of the requisite quoting obligations applicable to preferenced Market Makers. Preferenced Market Makers have heightened and burdensome quoting obligations to the market which do not apply to the non-preferenced Market Makers or to other market participants and therefore are assessed a lower fee when they transact with a Priority Customer complex order that was preferenced to them for execution.¹⁵ Firm Proprietary / Broker-Dealer, Non-ISE Market Maker¹⁶ and Professional Customer¹⁷ orders are currently assessed a higher fee than Market Makers while Priority Customers are not assessed a fee for removing liquidity from the complex order book, as is the case on competing exchanges.¹⁸

The Exchange operates in a highly competitive market in which market participants can easily and readily direct order flow to competing venues if they deem fee levels at a particular venue to be excessive. ISE and the other options exchanges are engaged in an intense

¹⁵ Preferenced market makers are required to continuously quote at least 90% of the series of an options class, whereas non-preferenced market makers are required to quote only 60% of the series of an options class. See ISE Rule 804(e).

¹⁶ A Non-ISE Market Maker, or Far Away Market Maker (“FARMM”), is a market maker as defined in Section 3(a)(38) of the Securities Exchange Act of 1934, registered in the same options class on another options exchange.

¹⁷ A Professional Customer is a person who is not a broker/dealer and is not a Priority Customer.

¹⁸ Firm Proprietary / Broker-Dealer, Non-ISE Market Maker and Professional Customer orders are currently charged \$0.40 per contract for removing liquidity in the Select Symbols (excluding SPY) and in the Non-Select Penny Pilot Symbols, \$0.41 per contract for removing liquidity in SPY and \$0.84 per contract for removing liquidity in the Non-Penny Pilot Symbols whereas Market Maker orders are currently charged \$0.39 per contract for removing liquidity in the Select Symbols (excluding SPY), in the Non-Select Penny Pilot Symbols and in SPY and \$0.82 per contract for removing liquidity in the Non-Penny Pilot Symbols. see also PHLX Pricing Schedule at <http://nasdaqomxphlx.cchwallstreet.com/NASDAQOMXPHLXTools/PlatformViewer.asp?selectednode=chp%5F1%5F4&manual=%2Fnasdaqomxphlx%2Fphlx%2Fphlx%2Drulesbrd%2F>.

competition on price (and other dimensions of competition) to attract order flow from order flow providers. Accordingly, the fees assessed by the Exchange must remain competitive with fees charged by other venues and therefore must continue to be reasonable and equitably allocated to those members that opt to send orders to the Exchange rather than to a competing venue.

In the PHLX Approval Order, the Commission employed a two part test to evaluate whether PHLX's proposal to adopt a \$0.05 per contract differential was consistent with the Act. First, the Commission examined whether the exchange making the proposal was subject to significant competitive forces in setting the terms of its proposal. The Commission noted that if the exchange making the proposal was subject to significant competitive forces in setting the terms of its proposal, the Commission will approve the proposal unless it determines that there is a substantial countervailing basis to find that the terms nevertheless fail to meet an applicable requirement of the Act or the rules thereunder.

With respect to the first part of the analysis, ISE notes that it is subject to significant competitive forces in setting the terms of any fee proposals, including this proposed fee change. The Commission has previously found that there is significant competition for order flow in the options markets.¹⁹ There currently are eleven registered national securities exchanges that trade listed options. Competition in the options market is evidenced by data PHLX provided in support of its filing to adopt a \$0.05 differential, noting that market share, based on contract volume, among the options exchanges, as of 2012, ranged from approximately less than 1% to

¹⁹ See Securities Exchange Act Release No. 61317 (January 8, 2010), 75 FR 2915 (January 19, 2010) (SR-ISE-2009-103) (finding that the exchange was subject to significant competitive forces in setting the terms of its proposal, including fees, and noting that “the Exchange has a compelling need to attract order flow to maintain its share of trading volume, imposing pressure on the Exchange to act reasonably in establishing fees for these data offerings”).

22% for equity options.²⁰ Further, six of the eleven options exchanges have rules that provide for the trading of complex orders.²¹ Further, data regarding market share among the options exchanges for complex orders also shows that there is significant competition for order flow. For example, for June 1, 2012, the market share for complex orders ranged from 3.39% for NYSE Arca, which had 74,486 complex order trades, to 43.79% for ISE, which had 961,040 complex order trades.²² Moreover, the volume for complex orders has been increasing over the past few years.²³ Additionally, the proposed fees will apply only to equity options that are able to be listed and traded on more than one options exchange, and are therefore subject to competition among the markets for order flow.²⁴

With respect to second part of the analysis, the Exchange does not believe that there is a substantial countervailing basis to find that the proposed rule change fails to meet the requirements of the Act or the rules thereunder. The Exchange notes that the fees for adding or removing liquidity as proposed distinguish between preferenced Market Makers and non-preferenced Market Makers, and would provide the preferenced Market Makers a lower fee than

²⁰ See Letter from Joan C. Conley, Senior Vice President and Corporate Secretary, NASDAQ OMX, dated July 26, 2012 (“PHLX Letter”).

²¹ See C2 Rule 6.13; CBOE Rules 6.42, 6.45, 6.53C; PHLX Rule 1080; NYSE Arca Rules 6.62(e), 6.91; NYSE MKT Rules 900.3NY(e), 963NY, 980NY.

²² See PHLX Supporting Data, at <http://www.sec.gov/comments/sr-phlx-2012-27/phlx201227-2.pdf>

²³ See Complex Orders Surge, Traders Magazine, March 2012 (noting increase in use of customer orders by customers at one broker-dealer in 2011); see also BATS February 2012 Options Market Update, at http://www.batstrading.com/resources/fee_schedule/2012/BATS-February-2012-USMarket-Update.pdf (noting that more volume is being done through complex strategies, and that volume in the complex order book has increased).

²⁴ There will be no discount for Singly Listed Symbols and FX Options Symbols because these symbols are traded only on ISE and therefore they are not subject to competition for order flow.

non-preferenced Market Makers when the preferenced Market Maker interacts with order flow that has been preferenced to them. The Exchange notes in part that preferenced Market Makers that execute against order flow in the complex order book that has been preferenced to them do not have a guaranteed allocation,²⁵ unlike in the leg market, and that the reduced fee for preferenced Market Makers is an attempt to confer an additional benefit on preferenced Market Makers for the value they provide in bringing order flow to the Exchange.

The Exchange further notes that increased order flow provides better execution quality on the Exchange because customers enjoy greater price transparency and executions at lower prices, and that Market Makers to whom order flow is preferenced still must compete with other Exchange participants to interact with that order flow to receive the benefits of such arrangements. This increased order flow, and corresponding greater execution quality, benefits all market participants.

The Commission has previously approved as consistent with the Act rules of exchanges that provide preferenced Market Makers a guaranteed allocation when they interact with preferenced order flow, based upon their status as preferenced market makers.²⁶ Likewise, preferenced Market Makers on ISE would be charged a lower fee when they interact with order flow preferenced to them, based on their status as preferenced Market Makers.

When approving the proposals that provided a guaranteed allocation to preferenced market makers, the Commission found that the guaranteed allocation for preferenced market makers would not affect the incentives of the trading crowd to compete aggressively for orders

²⁵ See supra note 10.

²⁶ See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (Order Approving SR-PHLX-2004-91).

based on price.²⁷ The Exchange believes that the potential impact of a guaranteed allocation on competition may be distinguished from the potential impact of the reduced transaction fee on competition. Specifically, the guaranteed allocation does not provide preferred market makers an explicit subsidy—in the form of lesser per contract fees—over other market makers that are competing to execute against the same order flow. Rather, the guaranteed allocation scheme allocates portions of orders to other market makers who are at the same price as the preferred market maker, thus protecting the incentive of other market makers to compete with preferred market makers on price. In contrast, assessing a lesser transaction fee on preferred market makers than other market makers when the preferred market makers interact with order flow preferred to them may allow preferred market makers to execute against complex orders at more aggressive prices than other market makers, which may reduce the incentive and ability of such other market makers to compete with preferred market makers on price.

The Exchange has considered the potential impact of the fees for adding and removing liquidity on preferred Market Makers and the \$0.05 fee differential on competition between preferred Market Makers and other Market Makers that are competing to execute against the same order flow. In the PHLX Approval Order, the Commission noted that for the two months during which the PHLX \$0.05 price differential was in effect, there was no statistically significant adverse impact on the competitiveness of the PHLX market for directed (i.e., preferred) customer complex orders. Given that the Exchange is proposing to implement the same \$0.05 cent differential for preferred Priority Customer complex orders, the Exchange believes there will not be any statistical significant adverse impact of the proposed fee differential on the competitiveness of the ISE market for preferred Priority Customer complex

²⁷

Id.

orders, or the extent of price improvement for preferenced Priority Customer complex orders on the ISE. Nevertheless, like PHLX, ISE is proposing to adopt the \$0.05 discount for preferenced Priority Customer complex orders on a pilot basis and will provide data to the Commission to further evaluate whether there is any adverse impact.²⁸

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

ISE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange believes this proposal, which seeks to adopt a fee discount applicable to Market Makers for executing orders that are preferenced to them, will enhance competition because the Exchange is seeking to adopt a fee discount that is already in place at one other exchange. The Exchange believes that the proposed rule change will promote competition, as it is designed to allow ISE to better compete for order flow and allow Market Makers to execute more of their transactions on the Exchange and therefore, improve the Exchange's competitive position. ISE also does not believe that the proposed rule change will impose any burden on competition among market participants on ISE that is not necessary or appropriate in furtherance of the purposes of the Act because, as noted above, preferenced Market Makers have heightened and burdensome quoting obligations to the market that non-preferenced Market Makers or other market participants do not have and therefore preferenced Market Makers may be assessed a

²⁸ For purposes of studying the competitive impact of the proposed fee change, ISE agrees to provide data on the rate of interaction with preferenced Priority Customer complex orders by both preferenced Market Makers and non-preferenced Market Makers. This data will cover the six months prior to the time the proposed fee was in effect. For the same time period, ISE also agrees to provide data on rates of price improvement for preferenced Priority Customer complex orders that received price improvement by both preferenced Market Makers and non-preferenced Market Makers. For the same time period, ISE also agrees to provide data on the percentage of preferenced and non-preferenced Priority Customer complex orders that received price improvement, and the average price improvement for such orders.

lower fee when they transact with Priority Customer complex orders that are preferenced to them for execution.

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act²⁹ and subparagraph (f)(2) of Rule 19b-4 thereunder,³⁰ because it establishes a due, fee, or other charge imposed by ISE.

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or 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:

²⁹ 15 U.S.C. 78s(b)(3)(A)(ii).

³⁰ 17 CFR 240.19b-4(f)(2).

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-ISE-2013-05 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090.

All submissions should refer to File Number SR-ISE-2013-05. This file number should be included on the subject line if e-mail 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 website (<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 website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington D.C., 20549-1090, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal offices 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 Number SR-ISE-2013-05, and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³¹

Kevin M. O'Neill
Deputy Secretary

³¹ 17 CFR 200.30-3(a)(12).