

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77821; File No. SR-ISE-2016-13)

May 12, 2016

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Schedule of 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 May 2, 2016, the International Securities Exchange, LLC (the “Exchange” or the “ISE”) 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 ISE proposes to eliminate Priority Customer complex order rebates for certain “net zero” complex orders. The text of the proposed rule change is available on the Exchange’s Web site (<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

Currently, the Exchange provides rebates to Priority Customer³ complex orders that trade with non-Priority Customer complex orders in the complex order book or trade with quotes and orders on the regular order book. Rebates are tiered based on a member's average daily volume ("ADV") executed during a given month as follows: 0 to 29,999 contracts ("Tier 1"), 30,000 to 59,999 contracts ("Tier 2"), 60,000 to 99,999 contracts ("Tier 3"), 100,000 to 149,999 ("Tier 4"), 150,000 to 199,999 contracts ("Tier 5"), and 200,000 or more contracts ("Tier 6"). In Select Symbols the rebate is \$0.30 per contract for Tier 1, \$0.35 per contract for Tier 2, \$0.41 per contract for Tier 3, \$0.44 per contract for Tier 4, \$0.46 per contract for Tier 5, and \$0.47 per contract for Tier 6. In Non-Select Symbols the rebate is \$0.63 per contract for Tier 1, \$0.71 per contract for Tier 2, \$0.79 per contract for Tier 3, \$0.81 per contract for Tier 4, \$0.83 per contract for Tier 5, and \$0.84 per contract for Tier 6.

Recently, a market participant has been entering a large volume of valueless complex orders that trade at a net price at or near \$0.00 (i.e., "net zero" complex orders) with the sole intention of earning a rebate.⁴ While these complex orders would generally not find a counterparty in the complex order book, they may leg in to the regular order book where they are typically executed by Market Makers⁵ on the individual legs. The fee that Market Makers

³ A "Priority Customer" is 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), as defined in ISE Rule 100(a)(37A).

⁴ For example, a market participant could enter a "net zero" complex order that buys 500 contracts of the \$193 March 6, 2016 SPY Put at a price of \$0.03 and sells 500 contracts of the \$193.50 March 6, 2016 SPY Put at a price of \$0.03 for a net price of \$0.00.

⁵ The term "Market Makers" refers to "Competitive Market Makers" and "Primary Market Makers" collectively. See ISE Rule 100(a)(25).

quoting in Select Symbols pay when a complex order legs into their quote is substantially higher than their fee or rebate for regular orders that trade against their quotes. In particular, a Market Maker providing liquidity on the individual leg would typically pay a maker fee of only \$0.10 per contract,⁶ or in the case of Market Makers that achieve Market Maker Plus status,⁷ would earn a maker rebate ranging from \$0.10 per contract to \$0.22 per contract. When trading against a Priority Customer complex order that legs in from the complex order book, however, that same Market Maker is charged a maker fee of \$0.30 per contract.⁸ In Non-Select Symbols, Market

⁶ This maker fee also applies to Non-ISE Market Maker, Firm Proprietary / Broker Dealer and Professional Customer orders in Select Symbols. Priority Customer orders are not charged a maker fee in Select Symbols for orders entered on the regular order book.

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

A “Firm Proprietary” order is an order submitted by a member for its own proprietary account.

A “Broker-Dealer” order is an order submitted by a member for a broker-dealer account that is not its own proprietary account.

A “Professional Customer” is a person or entity that is not a broker/dealer and is not a Priority Customer.

⁷ A Market Maker Plus is a Market Maker who is on the National Best Bid or National Best Offer a specified percentage of the time for series trading between \$0.03 and \$3.00 (for options whose underlying stock’s previous trading day’s last sale price was less than or equal to \$100) and between \$0.10 and \$3.00 (for options whose underlying stock’s previous trading day’s last sale price was greater than \$100) in premium in each of the front two expiration months. The specified percentage is at least 80% but lower than 85% of the time for Tier 1, at least 85% but lower than 95% of the time for Tier 2, and at least 95% of the time for Tier 3. A Market Maker’s single best and single worst quoting days each month based on the front two expiration months, on a per symbol basis, will be excluded in calculating whether a Market Maker qualifies for this rebate, if doing so will qualify a Market Maker for the rebate.

⁸ This higher maker fee for trading against a Priority Customer complex order that legs in to the regular order book also applies to Non-ISE Market Maker orders.

Makers pay a fee of \$0.25 per contract subject to certain tier discounts,⁹ or \$0.20 per contract for orders sent by an Electronic Access Member.¹⁰

By entering essentially valueless complex orders, this market participant or others employing the same strategy are able to recover rebates for essentially non-economic trades at the expense of the Exchange and the market participants on the other side of the trade. This behavior is a form of rebate arbitrage, and the Exchange believes that it is in the best interest of the Exchange and its members to remove the incentives that promote this activity. The Exchange therefore proposes to eliminate Priority Customer rebates for “net zero” complex orders that are entered on behalf of originating market participants that execute an ADV of at least 10,000 “net zero” complex orders in a given month. For purposes of determining which complex orders qualify as “net zero” the Exchange will count all complex orders that leg in to the regular order book and are executed at a net price that is within a range of \$0.01 credit and \$0.01 debit.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,¹¹ in general, and Section 6(b)(4) of the Act,¹² in particular, in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities.

⁹ See Schedule of Fees, Section IV.C.

¹⁰ There is no fee difference in Non-Select Symbols for trading against Priority Customer complex orders that leg in to the regular order book. Non-ISE Market Maker, Firm Proprietary / Broker-Dealer and Professional Customer orders in Non-Select Symbols are charged a fee of \$0.72 per contract. Priority Customer orders are not charged a fee in Non-Select symbols for orders entered on the regular order book.

¹¹ 15 U.S.C. 78f.

¹² 15 U.S.C. 78f(b)(4).

The Exchange believes that the proposed fee change is reasonable and equitable as it is designed to remove financial incentives for market participants to engage in rebate arbitrage by entering “net zero” complex orders on the Exchange that do not have any economic substance. As explained above, Priority Customer complex orders, including “net zero” complex orders that leg in to the regular order book, are currently paid significant rebates by the Exchange, which are funded in part by charging higher fees to the market participants that trade against these orders. The Exchange believes that eliminating the rebate provided to “net zero” complex orders will discourage market participants from entering these valueless orders, which are entered for the sole purpose of earning a rebate. The Exchange also believes that the proposed rule change is not unfairly discriminatory as it is designed to stop market participants from taking advantage of Exchange rebates by entering orders that lack economic substance. The Exchange is proposing to eliminate Priority Customer complex order rebates for all market participants that enter a large number of “net zero” complex orders. To the extent that those market participants enter legitimate complex orders, however, they will continue to receive the same rebates that they do today. In addition, market participants that enter an insubstantial volume of “net zero” complex orders will also continue to receive rebates. The Exchange does not believe that it is unfairly discriminatory to continue to offer rebates to firms that do not hit the proposed “net zero” ADV threshold as this more limited trading activity is not indicative of rebate arbitrage.

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

In accordance with Section 6(b)(8) of the Act,¹³ the Exchange does not believe that the proposed rule change will impose any burden on intermarket or intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change

¹³ 15 U.S.C. 78f(b)(8).

is designed to eliminate the ability for certain market participants to engage in rebate arbitrage to the detriment of the Exchange and its members. The Exchange operates in a highly competitive market in which market participants can readily direct their order flow to competing venues. In such an environment, the Exchange must continually review, and consider adjusting, its fees and rebates to remain competitive with other exchanges. For the reasons described above, the Exchange believes that the proposed fee changes reflect this competitive environment.

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 Act¹⁴ and subparagraph (f)(2) of Rule 19b-4 thereunder,¹⁵ 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.

¹⁴ 15 U.S.C. 78s(b)(3)(A)(ii).

¹⁵ 17 CFR 240.19b-4(f)(2).

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 e-mail to rule-comments@sec.gov. Please include File No. SR-ISE-2016-13 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE-2016-13. 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, DC 20549 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 office of the ISE. 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-2016-13 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁶

Robert W. Errett
Deputy Secretary

¹⁶ 17 CFR 200.30-3(a)(12).