SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80219; File No. SR-ISE-2017-22)

March 13, 2017

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend the Fee Schedule to Change the Definition of Net Zero Complex Order

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 1, 2017, 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 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.

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

The Exchange proposes to amend its Schedule of Fees to change the definition of net zero complex order for purposes of determining eligibility for Priority Customer complex order rebates.

While changes to the Schedule of Fees are effective upon filing, the Exchange has designated these changes to be operative on February 10, 2017.

The text of the proposed rule change is available on the Exchange's Website at www.ise.com, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

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 purpose of the proposed rule change to amend the Schedule of Fees to change the definition of net zero complex order for purposes of determining eligibility for Priority Customer complex order rebates. Currently, the Exchange does not provide Priority Customer rebates for complex orders that that leg in to the regular order book and trade at a net price at or near $0.00 (*i.e.*, net zero complex orders), provided those orders are entered on behalf of originating market participants that execute an ADV of at least 2,000 net zero complex orders in a given month.[3] 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 Makers[4] or other market participants on the individual legs who pay a fee to trade with this order flow. The Exchange does not provide rebates for net zero complex orders to prevent members from

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3 See Securities Exchange Act Release No. 77821 (May 12, 2016), 81 FR 31270 (May 18, 2016). See also SR-ISE-2017-16 (pending publication). Priority Customer complex orders that do not meet the definition of a net zero complex order, or that are entered on behalf of originating market participants that do not reach the 2,000 contract ADV threshold, remain eligible for rebates based on the tier achieved.

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

engaging in rebate arbitrage by entering valueless complex orders solely to recover rebates. For purposes of determining which complex orders qualify as net zero, the Exchange counts 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. In particular, the Exchange calculates the net price of the complex order by multiplying the quantity on each leg by the amount of credit or debit for that leg, and summing the prices calculated with respect to each leg. Based on that calculation, the complex order is counted as net zero if the net price is within a range of $0.01 credit and $0.01 debit. This methodology is illustrated in the example below.

Example 1:

SPY Feb 188 Put, Buy 270 contracts @ $0.01 = $2.70 debit

SPY Feb 193 Put, Sell 270 contracts @ $0.01 = ($2.70) credit

Net price = $0 (i.e., $2.70 - $2.70)

The Exchange believes that its current methodology does not fully capture the trading activity that this provision is meant to cover, as the market participants that are entering these net zero orders have found a way to continue to earn a rebate for their valueless trades at the expense of the Exchange and the members who trade against these complex orders when they leg in to the regular market. In particular, these market participants have been submitting complex orders that are essentially valueless on a per contract basis, but that result in a net credit or debit on a full trade basis that is not within $0.01 credit or $0.01 debit based on the methodology illustrated in the example above. The Exchange therefore proposes to change its methodology to look at the net price per contract, which the Exchange believes more accurately captures its intentions in eliminating rebates for net zero complex orders. To calculate the net price per contract, the Exchange will use the same methodology described above, and then divide the calculated net

price by the total quantity (i.e., the sum of the contracts for each leg).[5] The Exchange believes that this methodology will discourage market participants from engaging in this valueless conduct as these non-economic complex orders will no longer be rebate eligible. The example below illustrates the proposed net zero per contract methodology.

Example 2:

SPY Feb 188 Put, Buy 270 contracts @ $0.01 = $2.70 debit

SPY Feb 199 Put, Buy 180 contracts@ $0.02= $3.60 debit

SPY Feb 193 Put, Sell 450 contracts @ $0.01 = ($4.50) credit

Net price = $1.80 debit (i.e., $4.50 - $2.70 - $3.60)

Net price per contract = $0.002 debit (i.e., $1.80 ÷ 900)

Finally, the Exchange proposes to clarify that the current ADV threshold is based on the number of contracts executed in net zero complex orders. Although the Exchange has always calculated the ADV threshold, which is a measure of volume, based on the number of contracts executed, the Exchange believes that explicitly adding the word "contract" to this rule will avoid any possible confusion among members. Members will not receive rebates for net zero complex orders entered on behalf of originating market participants that execute an ADV of at least 2,000 contracts in net zero complex orders in a given month.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,[6] in general, and Section 6(b)(4) of the Act,[7] in particular, in that it is

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5 Complex orders executed from February 1, 2017 to February 9, 2017 will be provided rebates based on the net zero logic in place prior to this filing.

6 15 U.S.C. 78f.

7 15 U.S.C. 78f(b)(4).

designed to provide for the equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities.

The Exchange believes that the proposed per contract methodology 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. The Exchange currently has a rule in place to discourage members from entering net zero complex orders. The rule, however, is not sufficiently broad to stop this trading activity, as market participants continue to receive rebates for complex orders that would be considered net zero on a per contract basis. The Exchange is therefore proposing to modify its definition of a net zero complex order, consistent with its intent in adopting this provision. 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 changing the methodology used for determining net zero complex orders will discourage market participants from entering these valueless orders, which are entered for the sole purpose of earning a rebate.

In January 2017, no market participants met the 10,000 contract ADV threshold for net zero complex orders based on the current net zero criteria. In addition, no market participants that traded complex orders on the Exchange during January 2017 would have met the lower 2,000 contract ADV threshold implemented this February.[8] This is not due to market participants stopping this behavior but rather to firms modifying their activity to get around the net zero criteria implemented in the original net zero filing. With the proposed per contract change, the

[8] See supra note 3.

Exchange believes that market participants engaged in rebate arbitrage will be effectively prohibited from earning rebates for their net zero complex orders. In January 2017, for example, the Exchange notes that although no market participants met the net zero ADV threshold based on current criteria, five market participants would have met the current threshold based on the proposed criteria. Based on the proposed per contract methodology, each of these market participants executed a net zero ADV of greater than 7,000 contracts compared to a net zero ADV of less than 300 contracts for the next highest market participant, and an average net zero ADV of approximately 6 contracts for all market participants that entered complex orders on the Exchange during the month of January other than the five that would have surpassed the threshold. In addition, the Exchange notes that the vast majority of market participants that entered complex orders on the Exchange in January 2017 would continue to have a net zero ADV of 0 contracts based on the per contract methodology.

The continued submission by a handful of market participants of a high volume of net zero complex orders that leg into the regular order book has generated complaints from the Market Makers that trade against these orders in the regular order book, as firms recognize these net zero complex orders as essentially non-economic. The Exchange believes that adopting the proposed per contract methodology will make it more difficult for firms to continue to enter net zero complex orders purely to earn a rebate. This will reduce the cost of these trades to the Exchange and its members as firms are limited in the amount of this net zero complex order activity that they can conduct on the Exchange.

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 execute a large number of net zero complex orders based on the proposed methodology. To the extent that those market participants execute legitimate complex orders, however, they will continue to receive the same rebates that they do today. In addition, market participants that execute 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 net zero ADV threshold as this more limited trading activity is not indicative of rebate arbitrage. While the Exchange could prohibit rebates for any net zero complex orders without an ADV threshold, doing so would disadvantage innocent market participants that are not engaged in rebate arbitrage. The Exchange believes that the decision to allow rebates for firms with a limited ADV in net zero complex orders properly balances the need to encourage market participants to send order flow to the Exchange, and the need to prevent activity that is harmful to the market. Moreover, all market participants will be treated the same based on their net zero ADV.

Finally, the Exchange believes that addition of the word "contract" to the ADV threshold is reasonable, equitable, and not unfairly discriminatory as this change will clarify for members that the ADV threshold, which is a measure of volume, is calculated based on the number of contracts executed. The Exchange notes that this is not a change to the Exchange's current practice but is a simple clean up change to make the Schedule of Fees easier for members to understand.

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

In accordance with Section 6(b)(8) of the Act,[9] the Exchange does not believe that the proposed rule change will impose any burden on intermarket or intramarket competition that is

[9] 15 U.S.C. 78f(b)(8).

not necessary or appropriate in furtherance of the purposes of the Act. By refining the definition of net zero complex order, the proposed rule change is designed to eliminate the ability for certain market participants to engage in rebate arbitrage to the detriment of the Exchange and its members. In addition, adding the word "contract" to the ADV threshold is a non-substantive change made purely for clarification. 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

No written comments were either solicited or received.

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 Act,[10] and Rule 19b-4(f)(2)[11] thereunder. 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.

10 15 U.S.C. 78s(b)(3)(A)(ii).

11 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 Number SR-ISE-2017-22 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE-2017-22. 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 the 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 Number SR-ISE-2017-22 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.[12]

Eduardo A. Aleman
Assistant Secretary

[12] 17 CFR 200.30-3(a)(12).