

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-63843; File No. SR-ISE-2010-115)

February 4, 2011

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Approving Proposed Rule Change Regarding Registration, Qualification, and Continuing Education Requirements for Members and Associated Persons

I. Introduction

On December 1, 2010, the International Securities Exchange, LLC (“Exchange” or “ISE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to extend registration, qualification, and continuing education requirements to all associated persons of its members. The proposed rule change was published for comment in the Federal Register on December 21, 2010.³ The Commission received one comment letter on the proposal.⁴ This order approves the proposed rule change.

II. Background

The ISE’s rules governing registration, examination, and continuing education requirements for associated persons of ISE members⁵ currently apply to associated persons who

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 63554 (December 15, 2010), 75 FR 80091 (“Notice”).

⁴ See Letter from James McHale, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, to Elizabeth M. Murphy, Secretary, Commission (dated January 19, 2011) (“SIFMA Letter”).

⁵ Under ISE Rule 100(a)(3), the term “associated person” or “person associated with a member” means any partner, officer, director or branch manager of a member (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a member or any employee of a member. ISE noted that an organization could fall within the scope of this

conduct a public customer business. They are subject to Chapter 6 of the ISE's rules, Doing Business with the Public. Associated persons of member organizations register with the Exchange via the Uniform Application for Securities Industry Registration or Transfer ("Form U4") through the Financial Industry Regulatory Authority's ("FINRA") Central Registration Depository System ("Web CRD"), and must pass the General Securities Representative examination ("Series 7") to function as representatives if accepting orders from non-member customers.⁶ Options principals engaged in the supervision of options sales practices, must also pass the Registered Options Principal examination ("Series 4") or the General Securities Sales Supervisor examination ("Series 9/10").⁷ Rule 604, Continuing Education for Registered Persons, sets out the continuing education requirements for associated persons of members that conduct business with the public.

III. Description of the Proposal

ISE proposes to amend its rules regarding registration, examination, and continuing education of associated persons to make them substantially similar to the registration, examination, and continuing education requirements of FINRA. Specifically, ISE proposes to require all associated persons of members, regardless of whether they conduct a public customer or proprietary securities business, to register, qualify and comply with continuing education requirements.

Proposed Rule 313 establishes the qualification and registration requirements for associated persons of members, including registration requirements for the Chief Compliance

definition, but the Exchange is not intending to require registration by an organization. See Notice, p. 13; 75 FR 80091, at 80094.

⁶ See ISE Rule 602.

⁷ See ISE Rule 601.

Officer (“CCO”) of each member and for the Financial/Operations Principal (“FINOP”) of each member subject to Rule 15c3-1 of the Exchange Act.⁸ Proposed Rule 313 cross-references the existing registration, qualification and continuing education requirements set forth in Chapter 6,⁹ as well as the forms that must be filed to register or terminate the registration of an associated person.¹⁰

Proposed Rule 313(a)(1) will require registration and qualification by associated persons engaged or to be engaged in the securities business of a member.¹¹ The associated persons must be registered with the Exchange in the category of registration appropriate to the function to be performed as prescribed by the Exchange. Under proposed Rule 313 all associated persons that are not already registered in Web CRD must register (i.e., complete a Form U4)¹² and pass a qualification examination.¹³

⁸ 17 CFR 240.15c3-1.

⁹ See rules 601 – 603.

¹⁰ See proposed Rule 313(d) and Supplementary Material to Rule 313.03.

¹¹ An associated person is engaged in the securities business of a member if (i) the associated person conducts proprietary trading, acts as a market-maker, effects transactions on behalf of a broker-dealer account, supervises or monitors proprietary trading, market-making or brokerage activities on behalf of the broker-dealer, supervises or conducts training for those engaged in proprietary trading, market-making or brokerage activities on behalf of a broker-dealer account; or (ii) the associated person engages in the management of any associated person identified as an officer, partner or director. See proposed Supplementary Material to Rule 313.06.

An individual with an indirect ownership interest in a member that is engaged in the securities business of such member is required to register under proposed Rule 313.

¹² See proposed Supplementary Material to Rule 313.01.

¹³ ISE is working with other options self-regulatory organizations (“SROs”) to develop an examination for associated persons who previously have not been required to register under SRO rules (e.g., proprietary traders). See Notice, p. 16; 75 FR 80091, at 80095. See also Securities Exchange Act Release No. 63314 (November 12, 2010), 75 FR 70957 (November 19, 2010) (“CBOE Registration Order”).

Proposed Rule 313(b) requires the designation of a FINOP¹⁴ by each member that is subject to Exchange Act Rule 15c3-1,¹⁵ and proposed Rule 313(c) requires the designation of a CCO by each member. The FINOP and CCO are required to register and pass an appropriate qualification examination.¹⁶ The Exchange proposes to include a limited exemption from the requirement to pass the CCO qualification examination.¹⁷

Each member must register with ISE every associated person acting in the capacity of a sole proprietor, officer, partner, director, FINOP, or CCO.¹⁸ These associated persons must register as a principal on a Form U4 and pass principal qualification examinations. In addition, an associated person who is engaged in the supervision or monitoring of proprietary trading, market-making or brokerage activities and/or who is engaged in the supervision or training of those engaged in proprietary trading, market-making or brokerage activities will need to register and pass a principal qualification examination.¹⁹ Thus, all individuals who supervise the securities business of a member, or who oversee associated persons of the member, must register

¹⁴ The duties of a FINOP include assuring that the member complies with applicable financial and operational requirements under SRO rules and the Exchange Act.

¹⁵ 17 CFR 240.15c3-1.

¹⁶ Proposed Rule 313(b) establishes the Series 27 examination as the qualification examination for a FINOP. The qualification examination for a CCO is the Series 14 examination. See proposed Rule 313(c) and Notice, p. 18; 75 FR 80091, at 80095.

¹⁷ See proposed Rule 313(c).

¹⁸ See proposed Supplementary Material to Rule 313.07. This requirement is consistent with FINRA's registration requirement for Principals (NASD Rule 1021). Under ISE's proposed rules, anyone functioning as a principal must register as such with the Exchange via a Form U4 through FINRA's Web CRD. (Generally, all principals must qualify as representatives before qualifying as principals.)

ISE did not use the term "Principal" in the proposed rules to avoid confusion with existing terms, such as "Options Principal." In this order the Commission refers to such persons as principals.

¹⁹ Id.

and pass a principal qualification examination.²⁰

In addition, the Exchange requires each member to have at least two individuals registered as principals who qualify as such by passing the relevant principal examination.²¹ Proposed Supplementary Material to Rule 313.07 exempts members that are sole proprietors from this requirement. The Exchange may waive the requirement to have two principals if the member conclusively demonstrates that only one officer, partner or director is required.²² The ability to waive this registration requirement is consistent with similar FINRA rules regarding principal registration.²³ ISE is also proposing to allow a member that conducts only proprietary trading²⁴ and has 25 or fewer registered persons²⁵ to have only one officer or partner registered and subject to a principal examination.²⁵ Proposed Rule 313(a)(1) states that a member shall not maintain a registration with the ISE for any person (1) who is no longer active in the member's securities business; (2) who is no longer functioning in the registered capacity; or (3) where the

²⁰ If an ISE rule does not specify the examination that will qualify an associated person for a particular category of registration, once the ISE has determined the appropriate examination for that category, the ISE will file a proposed rule change indicating the appropriate examination.

²¹ This requirement is consistent with the registration requirement set forth in NASD Rule 1021. See proposed Supplementary Material to Rule 313.07.

²² The Commission expects this waiver to be used in very limited circumstances.

²³ See NASD Rule 1021(e).

²⁴ For purposes of this requirement, a member is considered to conduct only proprietary trading if it has the following characteristics: (i) the member is not required by Section 15(b)(8) of the Exchange Act to become a FINRA member and is a member of another registered securities exchange not registered solely under Section 6(g) of the Exchange Act; (ii) all funds used or proposed to be used by the member are the member's own capital, traded through the member's own accounts; (iii) the member does not, and will not, have customers; and (iv) all persons registered on behalf of the member acting or to be acting in the capacity of a trader must be owners of, employees of, or contractors to the member. See proposed Supplementary Material to Rule 313.07.

²⁵ See proposed Supplementary Material to Rule 313.07. This requirement is substantially similar to NASDAQ Rule 1021(e)(1).

sole purpose is to avoid an examination requirement. A member cannot register any person where there is no intent to employ that person in the member's securities business. However, a member may maintain or make application for the registration of an individual who performs legal, compliance, internal audit, back-office operations, or similar functions for the member, or a person who performs administrative support functions for registered personnel, or a person engaged in the securities business of a foreign securities affiliate or subsidiary of the member.

Proposed Rule 313(a)(2) identifies several categories of associated persons that are exempt from these additional registration requirements, which include (i) associated persons functioning solely and exclusively in a clerical or ministerial capacity; (ii) associated persons that are not actively engaged in the securities business; (iii) associated persons functioning solely and exclusively to meet a need for nominal corporate officers or for capital participation; and (iv) associated persons whose functions are solely and exclusively related to transactions in commodities, transactions in security futures and/or effecting transactions on the floor of another national securities exchange and who are registered as floor members with such exchange.²⁶

Proposed Rule 313(e) sets forth the requirements for examinations where there is a lapse in registration.²⁷ Specifically, an associated person is required to pass the appropriate qualification examination for the category of registration if the associated person's registration has been revoked by the Exchange as a disciplinary sanction or if his most recent registration has been terminated for a period of two or more years.

Proposed Supplementary Material to Rule 313.05 permits the Exchange to waive the qualification examination requirement in exceptional circumstances where good cause is

²⁶ This rule is substantially similar to NASD Rule 1060.

²⁷ This rule is substantially similar to NASD rules 1021(c) and 1031(c).

shown.²⁸

Proposed Supplementary Material to Rule 313.03 requires any member that discharges or terminates the employment or retention of an individual required to register under proposed Rule 313 to comply with the termination requirements, including the filing of a Form U5, set forth in Rule 601(c) and Rule 603.

Proposed Supplementary Material to Rule 313.04 requires associated persons required to register under proposed Rule 313 to satisfy the continuing education requirements set forth in Rule 604, or any other applicable continuing education requirements as prescribed by ISE.²⁹ The Exchange is adding a provision detailing the procedures required for in-house delivery of the regulatory element. The required procedures address responsibility for the continuing education program, site, technology, and supervision requirements, and administration of the program. Members are required to file a letter of attestation signed by a senior officer or partner with their Designated Examining Authority, confirming the establishment of the required procedures, and must annually represent that all required procedures have been continuously maintained. These

²⁸ See NASD Rule 1070 (Qualification Examinations and Waiver of Requirements) and NYSE Rule 345 (Employees – Registration, Approval, Records).

In determining whether a waiver shall be granted, the Exchange considers, among other things, previous industry employment, training and/or the successful completion of similar qualification examinations of other self-regulatory organizations. The Commission believes this waiver authority should be used sparingly and expects ISE to maintain records of waivers granted and to utilize careful judgment in granting waivers. Under the proposed Rule, associated persons whose activities are limited solely to the transaction of business on the floor of another exchange will be subject to the continuing education requirements set forth in Rule 604 or any other continuing education requirements prescribed by the Exchange.

²⁹ If the ISE prescribes different or additional continuing education requirements it must file a proposed rule change.

modifications will conform ISE's continuing education requirements to those of other SROs.³⁰

Finally, ISE proposes to make non-substantive changes to ISE Rule 601 (Registration of Options Principals), Rule 602 (Registration of Representatives) and Rule 603 (Termination of Registered Persons) to define and reference certain terms consistently within these rules and with proposed Rule 313.³¹

IV. Comment Letter

The Commission received one comment letter on the proposed rule change.³² The commenter asserts that the proposed rule change is overly broad in that it appears to impose registration, examination and continuing education requirements on associated persons in addition to those solely engaged in proprietary trading. The commenter also requested interpretive guidance and suggested several exemptions for associated persons from the new examination requirements.

The commenter requested confirmation that principals who are engaged in or supervise aspects of a member's securities business, other than proprietary trading, are not required to comply with the new registration, examination and continuing education requirements. These principals are already registered and qualified as general securities principals under ISE's rules. The ISE rules require associated persons to be registered in the category of registration appropriate to the function they perform, as prescribed by the Exchange. The intent of the proposed rule change is to ensure that all persons engaged in the securities business of member

³⁰ E.g., NASD Rule 1120; CBOE Rule 9.3A. See CBOE Registration Order, supra note 13. Also, while the Exchange does not have a floor, for consistency with other SRO rules, the Exchange also proposes to delete language that excludes those people whose activities are limited solely to the transaction of business on a floor from the definition of "registered person" for purposes of Rule 604.

³¹ See Notice, p. 21; 75 FR 80091, at 80096.

³² See supra note 4.

firms are subject to registration, examination and continuing education requirements. If the persons described by the commenter are already registered as general securities principals, then the Commission expects that they would not have to register under the new registration category as they are already qualified pursuant to ISE rules. Similarly, Series 7 licensed persons who conduct a retail business and are subject to continuing education requirements, would not need to register in the new registration category.³³

Additionally, the commenter proposed that the ISE accept the Series 24 examination as an alternative to the Series 14 examination for Chief Compliance Officers, and that the ISE should exempt from the Series 14 requirement Chief Compliance Officers with a current Series 24 license who have held the Series 24 license for a minimum of three years and have no regulatory history. The commenter also suggested that individuals with no regulatory history who currently hold the Series 24 and either the Series 9/10 or the Series 4 for a minimum of three years should not have to take a new trading examination, and that the same should apply to individuals with no regulatory history who are currently Series 7 as well as Series 9/10 or Series 4 licensed for a minimum of three years. The commenter also asked whether ISE will view the examination for proprietary traders being developed as a prerequisite to the Series 24 and the Series 9/10.

The Commission notes that ISE has the authority to waive the applicable qualification

³³ The commenter also raised certain questions solely pertinent to CBOE's filing and requested guidance regarding whether "risk managers" would be required to register under that SRO's new requirements. Although this comment is outside of the scope of this proposal, the Commission notes that CBOE rules exempt certain associated persons engaged in delineated activities from the new registration, examination and continuing education requirements. Unless a risk manager or associated person who has access to an exchange is specifically exempted from registering, those persons must register, pass an appropriate examination, and comply with continuing education requirements.

examination requirement and accept other standards as evidence of an applicant's qualifications for registration, if the applicant demonstrates good cause. The Commission understands that the new examination will serve as a prerequisite to the Series 24 and the Series 9/10 examinations for principals who are engaged solely in proprietary trading.

Finally, the commenter is concerned that ISE members will not have the opportunity to comment on the new examination. The Commission notes that any new examination created will be subject to the filing requirements of Section 19(b) of the Act and, as such, will be published in the Federal Register for comment.

V. Discussion and Commission Findings

In order to meet its obligations under Section 6 of the Act³⁴ to enforce compliance by member firms³⁵ and their associated persons with the Act, the rules thereunder, and the Exchange's own rules, an exchange must have baseline registration and examination requirements for all persons conducting business on an exchange, as well as for those supervising the activity. In addition, an exchange should have continuing education requirements for registered persons to help ensure that members and persons associated with their members are up to date on amendments to the Exchange's rules and the securities laws, rules, and regulations that govern their activities. Furthermore, the Exchange must have the information necessary to know if an associated person of a member firm is subject to a statutory disqualification.³⁶ This information is elicited by the Form U4, which is used by most SROs to

³⁴ Section 6 requires exchanges to have the ability to enforce compliance by their members and associated persons with the federal securities laws and with their own rules. 15 U.S.C. 78f.

³⁵ Broker and dealers are required to supervise the activities of their associated persons. See Section 15(b)(4)(E) of the Act.

³⁶ See Section 6(c)(2) of the Act and Rule 19h-1 under the Act. The Commission believes that it is important that certain registration information, such as whether an associated

register associated persons.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.³⁷ Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,³⁸ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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 proposed rule change is also consistent with Section 6(c)(3)(B) of the Act,³⁹ which authorizes exchanges to prescribe standards of training, experience and competence for persons associated with exchange members, and gives exchanges the authority to bar a natural person from becoming a member or a person associated with a member, if the person does not meet the standards of training, experience and competence prescribed in the rules of the exchange.

ISE's proposed rule change requires all associated persons of member organizations engaged in a securities business on ISE, as well as those who supervise, train or otherwise oversee those who do, to register with the Exchange via the Form U4, qualify by passing an appropriate examination, and comply with continuing education requirements. The Commission

person is subject to a statutory disqualification, be available to exchanges and other regulators, including the Commission and the state securities regulators, through WebCRD as well as members of the public through BrokerCheck, which derives information from WebCRD.

³⁷ 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).

³⁸ 15 U.S.C. 78f(b)(5).

³⁹ 15 U.S.C. 78f(c)(3)(B).

believes that ISE's requirements help ensure that all associated persons who transact business on ISE, including those engaged in proprietary trading, are subject to appropriate registration, qualification, and continuing education requirements and is consistent with the Act. These requirements bolster the integrity of the Exchange by helping to ensure that all associated persons engaged in a securities business are, and will continue to be, properly trained and qualified to perform their functions, will be supervised, and can be identified by regulators.

The Commission understands that the ISE is working with the other options exchanges to develop an exam for proprietary traders. The Commission expects the exam to be filed with the Commission no later than May 12, 2011.⁴⁰ If the exam is not filed by that time, the Commission expects ISE to require all associated persons engaged in the securities business of a member to promptly take and pass the Series 7 examination.

The requirement for each member to have a CCO who must register and pass the Series 14 and a FINOP who must register and pass the Series 27 is appropriate based on the heightened level of accountability inherent in the duty of overseeing compliance by an Exchange member, and in the oversight and preparation of financial reports, and the oversight of those employed in financial and operational capacities at each firm.

Additionally, the Commission believes that the requirement that all principals register through WebCRD and pass principal exams appropriately reflects the enhanced responsibility entrusted to principals. The requirement that members have at least two principals responsible for oversight of member organization activity on ISE, who must be registered as such and pass a principal exam, should help ISE strengthen the regulation of its member firms, and prepare those

⁴⁰ Associated persons of ISE members will have 90 days from the date the examination becomes available to take and pass the examination.

individuals for their responsibilities. The nature of the firm, however, may dictate that more than two principals are needed to provide appropriate supervision.

The Commission also believes ISE's proposed exceptions from the above-discussed general requirements are appropriate. Any member seeking an exception from the two principal requirement must provide evidence that conclusively indicates to the Exchange that only one principal is necessary. The Commission expects this authority to be used sparingly, because such persons oversee the operations of member firms and provide the first line of defense in ensuring that member firms are complying with the rules of the exchange as well as the federal securities laws. In addition, ISE may waive the qualification examination requirement in exceptional cases where the applicant has demonstrated that good cause exists to grant the waiver. The Commission also expects this authority to be used sparingly. Finally, the Commission notes that these exceptions are substantively the same as exceptions provided in similar rules at other SROs.⁴¹

The Commission believes the restrictions on registration that bar a member from maintaining a registration with ISE for (1) persons no longer active in the member's securities business, (2) persons no longer functioning in the registered capacity, or (3) for avoidance of an examination requirement, are appropriate. These limitations should help ensure that only persons qualified for their category of registration who are engaged in a securities business are able to transact business on the ISE.

The Commission notes that ISE has exempted several categories of associated persons from the new registration requirements. These persons would not be considered to be actively engaged in a securities business unless they are registered on the floor of another exchange, in

⁴¹ See, e.g., FINRA Rule 1070(d) and NASDAQ Rule 1070(d).

which case they would not have to register with ISE.⁴² The Commission understands that ISE's proposed rule change applies to all associated persons conducting a securities business, on a proprietary or agency basis, on ISE.

The Commission believes ISE's proposed provision requiring any person whose registration has been revoked by the Exchange as a disciplinary sanction, or whose most recent registration as a principal or representative has been terminated for a period of two or more years immediately preceding the date of receipt by the Exchange of a new application, to pass the qualification examination appropriate to such person's category of registration is appropriate. This requirement should help to ensure that an associated person's qualifications are current.⁴³

ISE's proposed rule change will help ensure that all associated persons of members transacting business on ISE, as well as those who supervise, train or otherwise oversee those who do, will be registered with, and qualified by, the Exchange and will be subject to continuing education requirements. The proposal will enhance ISE's ability to ensure an effective supervisory structure for those conducting business on ISE. The requirements apply broadly and are intended to help close a regulatory gap which has resulted in varying registration, qualification, and supervision requirements across markets. The Commission believes that the changes proposed by ISE to its rules will strengthen the regulatory structure of the Exchange and should enhance the ability of its members to comply with the Exchange's rules as well as with the federal securities laws.

⁴² See Notice, p. 17; 75 FR 80095. Such persons must comply with Section 15(b)(8) of the Exchange Act.

⁴³ Additionally, the Commission believes that the proposed revisions to Rules 601 (Registration of Options Principals), 602 (Registration of Representatives), and 603 (Termination of Registered Persons) to update certain references pertaining to registration and termination forms, as well as to WebCRD and FINRA, will provide clarity to ISE's rules, enabling regulators, members, and the general public to better understand the rules.

Additionally, the Commission believes that the proposed rule change is consistent with the principles of Section 11A(a)(1)(22) of the Act in that it seeks to assure fair competition among brokers and dealers and among exchange markets. The Commission believes that the proposed rule change will promote uniformity of regulation across markets, thus reducing opportunities for regulatory arbitrage. ISE's proposed rule change helps ensure that all persons conducting a securities business through ISE are appropriately supervised, as is required under the Exchange Act.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴⁴ that the proposed rule change (SR-ISE-2010-115), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁴⁵

Cathy H. Ahn
Deputy Secretary

⁴⁴ 15 U.S.C. 78s(b)(2).

⁴⁵ 17 CFR 200.30-3(a)(12).