

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-61154; File No. SR-ISE-2009-105)

December 11, 2009

Self-Regulatory Organizations, International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Registered Representative Fee and an Options Regulatory Fee

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 9, 2009, the International Securities Exchange, LLC (the “Exchange” or “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 Substance of the Proposed Rule Change

The ISE is proposing to amend its Schedule of Fees to eliminate registered representative fees and institute a new transaction-based “Options Regulatory Fee.” The text of the proposed rule change is available on the Exchange’s Web site (<http://www.ise.com>), at the Commission’s Web site at (<http://www.sec.gov>) 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

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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.

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

1. Purpose

This proposed rule change is based on a filing previously submitted by the Chicago Board Options Exchange (“CBOE”) that was effective on filing.<sup>3</sup> ISE proposes to amend its Schedule of Fees to eliminate registered representative fees and institute a new transaction-based “Options Regulatory Fee.” ISE rules require that members who do business with the public qualify and register their options principals and representatives. Each ISE member that registers an options principal and/or representative is assessed a registered representative fee (“RR Fee”) based on the action associated with the registration. RR Fees as well as other regulatory fees collected by the Exchange are intended to cover a portion of the cost of the Exchange’s regulatory programs. RR Fees have been in place since ISE’s inception in 2000 and remained unchanged until 2007.<sup>4</sup> There are annual fees as well as initial, transfer and termination fees. Today, all options exchanges, regardless of size, charge similar registered representative fees.

ISE believes the current RR Fee is not equitable. The options industry has evolved to a structure with many more Internet-based and discount brokerage firms. These firms have few registered representatives and thus pay very little in RR Fees compared to full service brokerage firms that have many registered representatives. More importantly, the regulatory effort the

---

<sup>3</sup> See Securities Exchange Act Release No. 58817 (October 20, 2008), 73 FR 63744 (October 27, 2008) (SR-CBOE-2008-105).

<sup>4</sup> See Securities Exchange Act Release No. 55899 (June 12, 2007), 72 FR 33794 (June 19, 2007) (SR-ISE-2007-30).

Exchange expends to review the transactions of each type of firm is not commensurate with the number of registered representatives that each firm employs.

Further, due to the manner in which RR Fees are charged, it is possible for a member firm to restructure its business to avoid paying these fees altogether. A firm can avoid RR Fees by terminating its ISE membership and sending its business to the Exchange through another member firm, even an affiliated firm that has many fewer registered representatives. Indeed, some firms have done just this to avoid paying these fees. If firms terminated their memberships to avoid RR Fees, the Exchange would suffer the loss of a major source of funding for its regulatory programs. The Exchange notes that at least three firms have terminated their membership to avoid RR Fees. The Exchange believes other firms may do the same unless the Exchange addresses its regulatory fee structure.

In order to address the inequity of the current regulatory fee structure and to curtail any further loss of memberships and by extension, loss of regulatory revenue, ISE proposes to eliminate the current RR Fee and adopt an Options Regulatory Fee (“ORF”) of \$0.0035 per contract, with a minimum one-cent charge per trade. This fee would be assessed by the Exchange to each member for all options transactions executed or cleared by the member that are cleared by The Options Clearing Corporation (“OCC”) in the customer range, i.e., transactions that clear in the customer account of the member’s clearing firm at OCC, regardless of the marketplace of execution. In other words, ISE would impose the ORF on all transactions executed by a member, even if the transactions do not take place on the Exchange.<sup>5</sup> The ORF

---

<sup>5</sup> The ORF would apply to all customer orders executed by a member on the Exchange. Exchange rules require each member to submit trade information in order to allow the Exchange to properly prioritize and match orders and quotations and report resulting transactions to the OCC. See ISE Rule 712. The Exchange represents that it has surveillances in place to verify that members comply with the rule.

would also be charged for transactions that are not executed by an ISE member but are ultimately cleared by an ISE member. In the case where an ISE member executes a transaction and an ISE member clears the transaction, the ORF would be assessed to the member who executed the transaction. In the case where a non-ISE member executes a transaction and an ISE member clears the transaction, the ORF would be assessed to the ISE member who clears the transaction.

The ORF would not be charged for member options transactions because members incur the costs of owning memberships and through their memberships are charged transaction fees, dues and other fees that are not applicable to non-members.<sup>6</sup> The dues and fees paid by members go into the general funds of the Exchange, a portion of which is used to help pay the costs of regulation. Based on the revenue model of the Exchange, member fees fund the bulk of the Exchange's operations and serve as the single-largest revenue source for the Exchange. Thus, the Exchange believes members are already paying their fair share of the costs of regulation.<sup>7</sup>

As noted, the ORF would replace RR Fees, which relate to a member's customer business. Further, RR Fees constituted the single-largest fee assessed that is related to customer trading activity (in that the Exchange generally does not charge customer transaction fees), the Exchange believes it is appropriate to charge the ORF only to transactions that clear as customer at the OCC. The Exchange believes that its broad regulatory responsibilities with respect to its members' activities supports applying the ORF to transactions cleared but not executed by a member. The Exchange's regulatory responsibilities are the same regardless of whether a

---

<sup>6</sup> For example, most non-broker-dealer customers are not charged transaction fees to trade on the Exchange.

<sup>7</sup> If the Exchange changes its method of funding regulation or if circumstances otherwise change in the future, the Exchange may propose to impose the ORF or a separate regulatory fee on members if the Exchange deems it advisable.

member executes a transaction or clears a transaction executed on its behalf. The Exchange regularly reviews all such activities, including performing surveillance for position limit violations, manipulation, frontrunning, contrary exercise advice violations and insider trading.<sup>8</sup> These activities span across multiple exchanges.

The Exchange believes the initial level of the fee is reasonable because it relates to the recovery of the costs of supervising and regulating members. In addition, the projected amount of revenue that the ORF is intended to generate for the Exchange, on an annual basis, is correlated to the amount of revenue that the RR Fee was intended to generate at the time the RR Fee was first announced by the Exchange in 2007. Since that time, however, the number of registered representatives has continued to materially decline, year over year. Customer transaction volume, on the other hand, on the Exchange and in the options industry overall, has, during that same period since 2007, materially and continuously increased, year over year. As a result, the spread between the amount of revenue collected under the RR Fee and the Exchange's actual costs in administering its regulatory program has continued to widen. As discussed herein, the Exchange believes that the number of declining registered representatives is a result of firms restructuring their business so as to avoid paying the RR Fee, to the extent that the fee has caused a drop of nearly 25% in the number of registered representatives in 2008, and

---

<sup>8</sup> The Exchange also participates in The Options Regulatory Surveillance Authority ("ORSA") national market system plan and in doing so shares information and coordinates with other exchanges designed to detect the unlawful use of undisclosed material information in the trading of securities options. ORSA is a national market system comprised of several self-regulatory organizations whose functions and objectives include the joint development, administration, operation and maintenance of systems and facilities utilized in the regulation, surveillance, investigation and detection of the unlawful use of undisclosed material information in the trading of securities options. The Exchange compensates ORSA for the Exchange's portion of the cost to perform insider trading surveillance on behalf of the Exchange. The ORF will cover the costs associated with the Exchange's arrangement with ORSA.

cumulatively more than 35% in 2009. Accordingly, by correlating the amount of revenue to be generated under the ORF to the amount of revenue that was intended to be collected by the RR Fee at the time it was announced by the Exchange in 2007, the Exchange believes the amount of the ORF is fair and reasonably allocated because it is a closer approximation to the Exchange's actual costs in administering its regulatory program.

The ORF would be collected indirectly from members through their clearing firms by OCC on behalf of the Exchange. The Exchange expects that member firms will pass-through the ORF to their customers in the same manner that firms pass-through to their customers the fees charged by Self Regulatory Organizations ("SROs") to help the SROs meet their obligations under Section 31 of the Exchange Act.

The ORF is designed to recover a material portion of the costs to the Exchange of the supervision and regulation of its members, including performing routine surveillances, investigations, as well as policy, rulemaking, interpretive and enforcement activities. The Exchange believes that revenue generated from the ORF, when combined with all of the Exchange's other regulatory fees, will cover substantially all of the Exchange's regulatory costs. At present, the total amount of regulatory fees collected by the Exchange is less than the regulatory costs incurred by the Exchange on an annual basis. RR Fees make up the largest part of the Exchange's total regulatory fee revenue. The Exchange generally does not charge customer transaction fees. The Exchange notes that its regulatory responsibilities with respect to member compliance with options sales practice rules have been allocated to FINRA under a 17d-2 agreement. The ORF is not designed to cover the cost of options sales practice regulation.

The Exchange would monitor the amount of revenue collected from the ORF to ensure that it, in combination with its other regulatory fees and fines, does not exceed regulatory costs.

The Exchange expects to monitor regulatory costs and revenues at a minimum on an annual basis. If the Exchange determines regulatory revenues exceed regulatory costs, the Exchange would adjust the ORF by submitting a fee change filing to the Commission. The Exchange would notify members of adjustments to the ORF via a Regulatory Information Circular.

The Exchange believes the proposed ORF is equitably allocated because it would be charged to all members on all their customer options business. The Exchange believes the proposed ORF is reasonable because it will raise revenue related to the amount of customer options business conducted by members, and thus the amount of Exchange regulatory services those members will require, instead of how many registered representative a particular member employs.<sup>9</sup>

As a fully-electronic exchange without a trading floor, the amount of resources required by ISE to surveil non-customer trading activity is significantly less than the amount of resources the Exchange must dedicate to surveil customer trading activity. This is because surveilling customer trading activity is much more labor-intensive and requires greater expenditure of human and technical resources than surveilling non-customer trading activity, which tends to be more automated and less labor-intensive. As a result, the costs associated with administering the customer component of the Exchange's overall regulatory program are materially higher than the costs associated with administering the non-customer component (e.g., market maker) of its regulatory program.

The Exchange believes it is reasonable and appropriate for the Exchange to charge the ORF for options transactions regardless of the exchange on which the transactions occur. The

---

<sup>9</sup> The Exchange expects that implementation of the proposed ORF will result generally in many traditional brokerage firms playing less regulatory fees while Internet and discount brokerage firms will pay more.

Exchange has a statutory obligation to enforce compliance by its members and their associated persons with the Exchange Act and the rules of the Exchange and to surveil for other manipulative conduct by market participants (including non-members) trading on the Exchange. The Exchange cannot effectively surveil for such conduct without looking at and evaluating activity across all options markets. Many of the Exchange's market surveillance programs require the Exchange to look at and evaluate activity across all options markets, such as surveillance for position limit violations, manipulation, frontrunning and contrary exercise advice violations.<sup>10</sup> Also, ISE and the other options exchanges are required to populate a consolidated options audit trail ("COATS") system in order to surveil member activities across markets.<sup>11</sup>

In addition to its own surveillance programs, the Exchange works with other SROs and exchanges on intermarket surveillance related issues. Through its participation in the Intermarket Surveillance Group ("ISG"),<sup>12</sup> the Exchange shares information and coordinates inquiries and investigations with other exchanges designed to address potential intermarket manipulation and trading abuses. The Exchange's participation in ISG helps it to satisfy the Exchange Act requirement that it have coordinated surveillance with markets on which security

---

<sup>10</sup> The Exchange and other options SROs are parties to a 17d-2 agreement allocating among the SROs regulatory responsibilities relating to compliance by the common members with rules for expiring exercise declarations, position limits, OCC trade adjustments, and Large Option Position Report reviews. See Securities Exchange Act Release No. 56941 (December 11, 2007).

<sup>11</sup> COATS effectively enhances intermarket options surveillance by enabling the options exchanges to reconstruct the market promptly to effectively surveil certain rules.

<sup>12</sup> ISG is an industry organization formed in 1983 to coordinate intermarket surveillance among the SROs by cooperatively sharing regulatory information pursuant to a written agreement between the parties. The goal of the ISG's information sharing is to coordinate regulatory efforts to address potential intermarket trading abuses and manipulations.



futures are traded and markets on which any security underlying security futures are traded to detect manipulation and insider trading.<sup>13</sup>

The Exchange believes that charging the ORF across markets will avoid having members direct their trades to other markets in order to avoid the fee and to thereby avoid paying for their fair share of regulation. If the ORF did not apply to activity across markets then members would send their orders to the least cost, least regulated exchange. Other exchanges could impose a similar fee on their member's activity, including the activity of those members on ISE.<sup>14</sup>

The Exchange notes that there is established precedent for an SRO charging a fee across markets, namely, FINRA's Trading Activity Fee<sup>15</sup> and the CBOE's ORF.<sup>16</sup> While the Exchange does not have all the same regulatory responsibilities as FINRA, the Exchange believes that, like the CBOE, its broad regulatory responsibilities with respect to its members' activities, irrespective of where their transactions take place, supports a regulatory fee applicable to transactions on other markets. Unlike FINRA's Trading Activity Fee, the ORF would apply only to a member's customer options transactions.

The Exchange has designated this proposal to be operative on January 1, 2010.

## 2. Statutory Basis

---

<sup>13</sup> See Exchange Act Section 6(h)(3)(I).

<sup>14</sup> The Exchange notes that the Chicago Board Options Exchange ("CBOE") currently assesses an options regulatory fee similar to the one proposed herein, which fee is also assessed on the trading activity of a CBOE member on ISE.

<sup>15</sup> See Securities Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003).

<sup>16</sup> See supra Note 1 [sic].

The basis under the Securities Exchange Act of 1934 (the "Exchange Act") for this proposed rule change is the requirement under Section 6(b)(4) that an exchange have an equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities. The Exchange believes the ORF is objectively allocated to ISE members because it would be charged to all members on all their transactions that clear as customer at the OCC. Moreover, the Exchange believes the ORF ensures fairness by assessing higher fees to those member firms that require more Exchange regulatory services based on the amount of customer options business they conduct.

The Commission has addressed the funding of an SRO's regulatory operations in the Concept Release Concerning Self-Regulation<sup>17</sup> and the release on the Fair Administration and Governance of Self-Regulatory Organizations.<sup>18</sup> In the Concept Release, the Commission states that: "Given the inherent tension between an SRO's role as a business and a regulator, there undoubtedly is a temptation for an SRO to fund the business side of its operations at the expense of regulation."<sup>19</sup> In order to address this potential conflict, the Commission proposed in the Governance Release rules that would require an SRO to direct monies collected from regulatory fees, fines, or penalties exclusively to fund the regulatory operations and other programs of the SRO related to its regulatory responsibilities.<sup>20</sup> The Exchange has designed the ORF to generate revenues that, when combined with all of the Exchange's other regulatory fees, will

---

<sup>17</sup> See Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256 (December 8, 2004) ("Concept Release").

<sup>18</sup> See Securities Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126 (December 8, 2004) ("Governance Release").

<sup>19</sup> Concept Release at 71268.

<sup>20</sup> Governance Release at 71142.

approximately be equal to the Exchange's regulatory costs, which is consistent with the Commission's view that regulatory fees be used for regulatory purposes and not to support the Exchange's business side.

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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 Act<sup>21</sup> and paragraph (f)(2) of Rule 19b-4<sup>22</sup> thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate 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.

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:

---

<sup>21</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>22</sup> 17 CFR 240.19b-4(f)(2).

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2009-105 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 DC 20549–1090.

All submissions should refer to File Number SR-ISE-2009-105. 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 Web site (<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 inspection and copying in the Commission’s Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such 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 No. SR-ISE-2009-105 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>23</sup>

Florence E. Harmon  
Deputy Secretary

---

<sup>23</sup> 17 CFR 200.30-3(a)(12).