This document is scheduled to be published in the
Federal Register on 05/02/2013 and available online at
http://federalregister.gov/a/2013-10346, and on **FDsys.gov**

8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69467; File No. SR-ISE-2013-15)

April 26, 2013

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Granting Approval of a Proposed Rule Change to Amend the Obvious and Catastrophic Errors Rule

I. Introduction

On February 26, 2013, the International Securities Exchange, LLC (the "Exchange" or the "ISE") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend Rule 720, Obvious and Catastrophic Errors. The proposed rule change was published for comment in the Federal Register on March 14, 2013.[3] The Commission received no comment letters on the proposal. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange proposes to amend Rule 720 relating to obvious error and catastrophic error rules by: 1) providing that, in the case of both obvious and catastrophic errors, the Exchange will nullify trades for transactions involving Priority Customers[4] and adjust trades where none of the parties to the trade are Priority Customers; and 2) harmonizing the procedure for making obvious and catastrophic error determinations.

Erroneous Transactions Involving Priority Customers

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

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 69085 (March 8, 2013), 78 FR 16338 ("Notice").

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

Under current Rule 720(b)(2), the Exchange nullifies obvious error transactions unless all parties to the trade are ISE market makers, in which case the Exchange adjusts the price of the transaction. With respect to catastrophic errors, the Exchange currently adjusts all transactions even if they involve non-market makers.[5]

The Exchange proposes to amend its obvious and catastrophic error procedures to allow the Exchange to nullify trades that qualify as either an obvious error or a catastrophic error if such trades involved a Priority Customer and adjust trades where none of the parties to the trade are Priority Customers (i.e., market makers, broker-dealers and professional customers). Specifically, the Exchange proposes to amend Rule 720(b)(2)(ii) and adopt new Rule 720(c)(2)(B),[6] which states that where at least one party to the obvious or catastrophic error is a Priority Customer, the trade will be nullified by Market Control[7] unless both parties agree to an adjustment price for the transaction within thirty (30) minutes of being notified by Market Control of its determination. The Exchange believes that this proposal provides a fair way to address the issue of a trade executing through a customer's limit order price while balancing the competing interests of certainty that trades stand with the policy concerns about dealing with true errors.

Determination of Erroneous Transactions

Under Rule 720(b)(2), Market Control determines whether an obvious error has occurred and applies the rule to adjust or nullify trades with the ability for those parties affected to request

5 See ISE Rule 720(d)(3).

6 This proposed rule change also realigns certain parts of Rule 720. The rule on Catastrophic Error Procedure rule was previously found in Rule 720(d) and with the proposed realignment, this rule now appears as Rule 720(c).

7 Market Control consists of designated personnel in the Exchange's market control center. See ISE Rule 720(a)(3)(ii).

that a panel of members review decisions made by Market Control. With respect to catastrophic errors, Rule 720(d)(2) currently requires that a panel of members make the initial determination of whether a catastrophic error occurred rather than Market Control.

The Exchange proposes to amend the catastrophic error procedure to provide that Market Control shall make the initial determination of whether or not a catastrophic error has occurred. The Exchange's proposed procedure would allow parties affected by an action taken by Market Control the ability to request that such actions be reviewed by a member panel, rather than requiring a member panel to make the initial determination in all cases. The Exchange's proposed rule also sets forth the steps that Market Control shall take if a determination has been made that a catastrophic error has occurred.[8]

The Exchange also proposes to rearrange parts of Rule 720. Specifically, the Exchange proposes to delete Rule 720(c) (Obvious Error Panel) and move the substance of that rule to new Rule 720(d), which is also renamed Review Panel, and which will now apply to both obvious and catastrophic errors. Proposed Rule 720(d) will provide the composition of the Review Panel,[9] the scope of the Review Panel's review,[10] the procedure for requesting review,[11] and the decisions of the Review Panel.[12]

---

8 See Proposed Rule 720(c)(2).

9 See Proposed Rule 720(d)(1).

10 See Proposed Rule 720(d)(2).

11 See Proposed Rule 720(d)(3).

12 See Proposed Rule 720(d)(4). The Exchange is also proposing conforming amendments to Supplementary Material .01, .02, .03 and .04 to Rule 720 to reflect the proposed rule changes.

III. Discussion

The Commission has carefully considered the proposed rule change and 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.[13] Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[14] in that the proposed change is designed to promote just and equitable principles of trade, will serve to remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest.[15]

In the filing, the Exchange notes its belief that the proposed rule change relating to nullifying trades involving Priority Customers and adjusting trades where none of the parties are Priority Customers will help market participants better manage their risk associated with potential erroneous trades. The Exchange notes that the proposed rule change is not unfairly discriminatory, even though it offers some market participants a choice as to whether a trade is nullified or adjusted, while other market participants will continue to have all of their obvious and catastrophic errors adjusted. Specifically, the Exchange notes that the existing rules differentiate among market participants.[16] The Exchange notes further that options rules often treat Priority Customers in a special way,[17] recognizing that Priority Customers are not

---

13 In approving the 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).

14 15 U.S.C. 78f(b)(5).

15 15 U.S.C. 78o-4(b)(2)(C).

16 The Exchange notes, for example, that the notification period to begin the obvious error process is different for Exchange market makers and non-market makers and whether a trade is adjusted or busted also differs.

17 For example, many options exchanges priority rules treat Priority Customer orders differently and some options exchanges only accept certain types of orders from Priority

necessarily immersed in the day-to-day trading of the markets, less likely to be watching trading activity in a particular option throughout the day, and may have limited funds in their trading accounts. The Exchange goes on to note that, while the proposed rule change may introduce uncertainty regarding whether a trade will be adjusted or nullified, it eliminates price uncertainty, as customer orders can be adjusted to a significantly different price than their limit order price under the rule prior to this proposed rule change. Ultimately, the Exchange believes differentiating among market participants by permitting Priority Customers to have a choice as to whether to nullify a trade involving an obvious or a catastrophic error is not unfairly discriminatory, because it is reasonable and fair to provide Priority Customers with additional options to protect themselves against the consequences of obvious and catastrophic errors.

The Commission notes that in considering the proposed rule change, the Exchange has weighed the benefits of certainty to non-broker-dealer customers that their limit price will not be violated against the costs of increased uncertainty to other market participants such as market makers and broker-dealers that their trades may be nullified instead of adjusted depending on whether the other party to the transaction is or is not a Priority Customer. The proposed rule change takes an approach similar to the one taken in the Exchange's existing obvious error rule, whereby transactions in which an obvious error occurred with at least one party that is not an Exchange market maker are nullified unless both parties agree to adjust the price of the transaction within 30 minutes of being notified of the obvious error.

Further, the Commission believes that the proposed rule change relating to Market Control making the determination of whether a catastrophic error has occurred will promote just and equitable principles of trade by adding certainty and more consistency to the current rule.

Customers. Most options exchanges also charge different fees for Priority Customer orders.

The Exchange noted that, in its experience, the procedure of requiring a member panel to make the initial determination of whether or not a catastrophic error has occurred in all cases is inefficient and unnecessary. The Exchange stated that its obvious and catastrophic error rule and the procedures that carry out the rule have consistently been based on specific and objective criteria. The Exchange noted that this proposal furthers that principle by adopting objective guidelines for the determination of which trades may be nullified or adjusted, and for the determination of whether or not a trade is deemed to be a catastrophic error. For the reasons noted above, the Exchange believes that the proposed rule change is consistent with the Act.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[18] that the proposed rule change (SR-ISE-2013-15) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[19]

Kevin M. O'Neill
Deputy Secretary

[FR Doc. 2013-10346 Filed 05/01/2013 at 8:45 am; Publication Date: 05/02/2013]

---

18 15 U.S.C. 78s(b)(2).

19 17 CFR 200.30-3(a)(12).