



8011-01P

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-75804; File No. SR-ISE Gemini-2015-14)

September 1, 2015

Self-Regulatory Organizations; ISE Gemini, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Adopting a Principles-Based Approach to Prohibit the Misuse of Material, Non-public Information by Market Makers by Deleting Rule 810

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 August 31, 2015, ISE Gemini, LLC (the “Exchange” or the “ISE Gemini”) 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 Exchange has designated this proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6)(iii) thereunder,⁴ which renders it effective upon filing with the Commission. 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

ISE Gemini proposes to adopt a principles-based approach to prohibit the misuse of material, non-public information by market makers by deleting Rule 810. The text of the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6)(iii).

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.

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 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

(a) Purpose –

The Exchange proposes to adopt a principles-based approach to prohibit the misuse of material, non-public information by market makers by deleting Rule 810. In so doing, the Exchange would harmonize its rules amongst its Members⁵ relating to protecting against the misuse of material, non-public information. The Exchange believes that Rule 810 is no longer necessary because all Members, including market makers, are subject to the Exchange’s general principles-based requirements governing the protection against the misuse of material, non-public information, pursuant to Exchange Rules, Chapter 4 – Business Conduct, Rule 408 (Prevention of the Misuse of Material Nonpublic Information), section (a) (“Rule 408(a)”), which obviates the need for separately-prescribed requirements for a subset of market participants on the Exchange.

Background

⁵ The term “Member” means an organization that has been approved to exercise trading rights associated with Exchange Rights. See Rule 100(a)(23).

The Exchange has two classes of registered market makers. Pursuant to Rule 800, a market maker is a Member with Designated Trading Representatives that is registered with the Exchange for the purpose of making transactions as a dealer-specialist. As the rule further provides, a market maker can be either a CMM or a PMM. All market makers are subject to the requirements of Rules 803 and 804, which set forth the obligations of market makers, particularly relating to quoting.

Rule 803 specifies the obligations of market makers, which include making markets that, absent changed market conditions, will be honored for the number of contracts entered into the Exchange's System in all series of options classes to which the market maker is appointed. The quoting obligations of market makers are set forth in Rule 804. That rule sets forth the main difference between PMMs and CMMs, namely that PMMs have a heightened quoting obligation as compared to CMMs.⁶ In addition to a heightened quoting obligation pursuant to Rule 804, an Electronic Access Member may designate a Preferred Market Maker⁷ on orders it enters into the System ("Preferred Orders"). These Preferred Market Makers, quoting at the NBBO at the

⁶ Compare Rule 804(e)(1) ("Primary Market Makers. Primary Market Makers must enter continuous quotations and enter into any resulting transactions in all of the series listed on the Exchange of the options classes to which it is appointed on a daily basis.") with 804(e)(2) ("Competitive Market Makers. (i) On any given day, a Competitive Market Maker is not required to enter quotations in the options classes to which it is appointed. (ii) A Competitive Market Maker may initiate quoting in options classes to which it is appointed intraday. (iii) Whenever a Competitive Market Maker enters a quote in an options class to which it is appointed, it must maintain continuous quotations in that class for 60% of the time the class is open for trading on the Exchange; provided, however, that a Competitive Market Maker shall be required to maintain continuous quotations for 90% of the time the class is open for trading on the Exchange in any options class in which it receives Preferred Orders....").

⁷ A Preferred Market Maker may be the PMM appointed to the options class or any CMM appointed to the options class.

time the Preferred Order is received, are eligible to receive a greater allocation of participation rights.⁸

Importantly, all market makers have access to the same information in the order book that is available to all other market participants. Moreover, none of the Exchange's market makers have agency obligations to the Exchange's order book. As such, the distinctions between PMMs and CMMs are the quoting requirements set forth in Rule 804.

Notwithstanding that market makers have access to the same Exchange trading information as all other market participants on the Exchange, the Exchange has specific rules governing how market makers may operate. Rule 810 allows market makers to engage in Other Business Activities⁹ and to be affiliated with a broker-dealer that engages in Other Business Activities only if there is an Information Barrier between the marking making activities and the Other Business Activities. The Rule further provides that market makers must implement detailed Exchange-approved procedures to restrict the flow of material, non-public information. Rule 810(b) outlines the organizational structure of the Information Barrier, which a market maker must implement to meet the requirements of Rule 810(a). The Information Barrier is meant to ensure that a market maker will not have access to material, non-public information while engaging in Other Business Activities and that a market maker will not misuse material, non-public information obtained from an affiliated broker-dealer engaged in the Other Business Activities.

Proposed Rule Change

⁸ .03 of Supplementary Material to Rule 713.

⁹ Other Business Activities means “(1) conducting an investment or banking or public securities business; (2) making markets in the stocks underlying the options in which it makes markets; or (3) handling listed options orders as agent on behalf of Public

The Exchange believes that the guidelines in Rule 810, for market makers, are no longer necessary and proposes to delete it. Rather, the Exchange believes that Rule 408(a) governing the misuse of material, non-public information provides for an appropriate, principles-based approach to prevent the market abuses Rule 810 is designed to address. Specifically Rule 408(a) requires every Exchange Member to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the Member's business, to prevent the misuse of material, non-public information by such Member or associated person. For purposes of this requirement, the misuse of material, non-public information includes, but is not limited to, the following:

- (a) trading in any securities issued by a corporation, partnership, or Funds, as defined in Rule 502(h), or a trust or similar entities, or in any related securities or related options or other derivative securities, or in any related non-U.S. currency, non-U.S. currency options, futures or options on futures on such currency, or any other derivatives based on such currency, or in any related commodity, related commodity futures or options on commodity futures or any other related commodity derivatives, while in possession of material nonpublic information concerning that corporation or those Funds or that trust or similar entities;
- (b) trading in an underlying security or related options or other derivative securities, or in any related non-U.S. currency, non-U.S. currency options, futures or options on futures on such currency, or in any related commodity, related commodity futures or options on commodity futures or any other related commodity derivatives, or any other derivatives based on such currency while in possession

Customers or broker-dealers; (4) conducting non-market making proprietary listed options trading activities.”

of material nonpublic information concerning imminent transactions in the above;
and

- (c) disclosing to another person any material nonpublic information involving a corporation, partnership, or Funds or a trust or similar entities whose shares are publicly traded or an imminent transaction in an underlying security or related securities or in the underlying non-U.S. currency or any related non-U.S. currency options, futures or options on futures on such currency, or in any related commodity, related commodity futures or options on commodity futures or any other related commodity derivatives, or any other derivatives based on such currency for the purpose of facilitating the possible misuse of such material nonpublic information.

Because market makers are already subject to the requirements of Rule 408(a) and because market makers do not have any trading or information advantage over other Members, the Exchange does not believe that it is necessary to separately require specific limitations on dealings between market makers and their affiliates. Deleting Rule 810 would provide market makers and Members with the flexibility to adapt their policies and procedures as reasonably designed to reflect changes to their business model, business activities, or the securities market in a manner similar to how Members on the Exchange currently operate and consistent with Rule 408(a). However, the Exchange notes that deleting Rule 810 does not obviate the need for reasonably designed information barriers in certain situations.

As noted above, PMMs and CMMs are distinguished under Exchange rules only to the extent that PMMs have heightened obligations and allocation guarantees. However, none of these heightened obligations provides different or greater access to non-public information than

any other market participant on the Exchange.¹⁰ Specifically, market makers on the Exchange do not have access to trading information provided by the Exchange, either at, or prior to, the point of execution, that is not made available to all other market participants on the Exchange in a similar manner. Further, as noted above, market makers on the Exchange do not have any agency responsibilities for orders on the order book. Accordingly, because market makers do not have any trading advantages at the Exchange due to their market role, the Exchange believes that they should be subject to the same rules as Members regarding the protection against the misuse of material, non-public information, which in this case, is existing Rule 408(a).

The Exchange notes that even with this proposed rule change, pursuant to Rule 408(a), a market maker would still be obligated to ensure that its policies and procedures reflect the current state of its business and continue to be reasonably designed to achieve compliance with applicable federal securities law and regulations, and with applicable Exchange rules, including being reasonably designed to protect against the misuse of material, non-public information. While information barriers would not specifically be required under the proposal, Rule 408(a) already requires that a Member consider its business model or business activities in structuring its policies and procedures, which may dictate that an information barrier or a functional separation be part of the set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities law and regulations, and with applicable Exchange rules.

The Exchange is not proposing to change what is considered to be material, non-public information and, thus does not expect there to be any changes to the types of information that an affiliated brokerage business of a market maker could share with such market maker. In that

¹⁰ See Rules 802(e) and 803.

regard, the proposed rule change will not permit the EAM unit of a member to have access to any non-public order or quote information of the affiliated market maker, including hidden or undisplayed size or price information of such orders and quotes. Market makers are not allowed to post hidden or undisplayed orders and quotes on the Exchange. Members do not expect to receive any additional order or quote information as a result of this proposed rule change.

Further, the Exchange does not believe that there will be any material change to member information barriers as a result of removal of the Exchange's pre-approval requirements. In fact, the Exchange anticipates that eliminating the pre-approval requirement should facilitate implementation of changes to member information barriers as necessary to protect against the misuse of material, non-public information. The Exchange also suggests that the pre-approval requirement is unnecessary because market makers do not have agency responsibilities to the book, or time and place information advantages because of their market role. However, as is the case today with market makers, information barriers of new entrants would be subject to review as part of a new firm application. Moreover, the policies and procedures of market makers, including those relating to information barriers, would be subject to review by FINRA, on behalf of the Exchange, pursuant to a Regulatory Services Agreement.

The Exchange further notes that under Rule 408(a), a Member would be able to structure its firm to provide for its options market makers, as applicable, to be structured with its equities and customer-facing businesses, provided that any such structuring would be done in a manner reasonably designed to protect against the misuse of material, non-public information. For example, pursuant to Rule 408(a) a market maker on the Exchange could be in the same independent trading unit, as defined in Rule 200(f) of Regulation SHO,¹¹ as an equities market

¹¹ 17 CFR Part 242.200(f).

maker and other trading desks within the firm, including options trading desks, so that the firm could share post-trade information to better manage its risk across related securities. The Exchange believes it is appropriate, and consistent with Rule 408(a) and Section 15(g) of the Act¹² for a firm to share options position and related hedging position information (e.g., equities, futures, and foreign currency) within a firm to better manage risk on a firm-wide basis. The Exchange notes, however, that if so structured, a firm would need to have policies and procedures, including information barriers as applicable, reasonably designed to protect against the misuse of material, non-public information, and specifically customer information, consistent with Rule 408(a).

The Exchange believes that the proposed reliance on the principles-based Rule 408(a) would ensure that a Member that operates a market maker would be required to protect against the misuse of any material, non-public information. As noted above, Rule 408(a) already requires that firms refrain from trading while in possession of material, non-public information concerning imminent transactions in the security or related product. The Exchange believes that moving to a principles-based approach rather than prescribing how and when to wall off a market maker from the rest of the firm would provide Members operating as market makers with appropriate tools to better manage risk across a firm, including integrating options positions with other positions of the firm or, as applicable, by the respective independent trading unit. Specifically, the Exchange believes that it is appropriate for risk management purposes for a member operating a market maker to be able to consider both options market makers traded positions for purposes of calculating net positions consistent with Rule 200 of Regulation SHO, calculating intra-day net capital positions, and managing risk both generally as well as in

¹² 15 U.S.C. 78o(g).

compliance with Rule 15c3-5 under the Act (the “Market Access Rule”).¹³ The Exchange notes that any risk management operations would need to operate consistent with the requirement to protect against the misuse of material, non-public information.

The Exchange further notes that if market makers are integrated with other market making operations, they would be subject to existing rules that prohibit Members from disadvantaging their customers or other market participants by improperly capitalizing on a member organization’s access to the receipt of material, non-public information. As such, a member organization that integrates its market maker operations together with equity market making would need to protect customer information consistent with existing obligations to protect such information. The Exchange has rules prohibiting Members from disadvantaging their customers or other market participants by improperly capitalizing on the Members’ access to or receipt of material, nonpublic information. For example, Rule 609 requires members to establish, maintain, enforce, and keep current a system of compliance and supervisory controls, reasonably designed to achieve compliance with applicable securities laws and Exchange rules. Additionally, Rule 400 prevents a person associated with a Member, who has knowledge of all material terms and conditions of (i) an order and a solicited order, (ii) an order being facilitated, or (iii) orders being crossed; the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option for the same underlying security as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument unless certain circumstances are met.¹⁴

¹³ 17 CFR Part 240.15c3-5.

¹⁴ .02 of Supplementary Material to Rule 400.

Additionally, the Exchange proposes to amend the text of Supplementary Material .06 to Rule 717 to match a recent change made by International Securities Exchange, LLC (“ISE”).¹⁵ The Exchange further notes that the changes proposed in this filing to Rule 717 have no substantive effect on the rule -- Members may still demonstrate that orders were entered without knowledge of a pre-existing order on the book represented by the same firm by providing evidence that effective information barriers between the persons, business units and/or systems entering the orders onto the Exchange were in existence at the time the orders were entered. The rule requires that such information barriers be fully documented and provided to the Exchange upon request.

(b) Basis –

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹⁶ in general, and furthers the objectives of Section 6(b)(5)¹⁷ in particular, in that it is 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 Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market by adopting a principles based approach to permit a Member operating a market maker to maintain and enforce policies and procedures to, among other things, prohibit the misuse of material, non-public information and eliminate restrictions on how a Member structures its market making operations. The Exchange notes that the proposed rule change is based on an approved rule of the Exchange to which market makers

¹⁵ See SR-ISE-2015-26 (notice pending publication in the Federal Register).

¹⁶ 15 U.S.C. § 78f(b).

¹⁷ 15 U.S.C. § 78f(b)(5).

are already subject – Rule 408(a) – and harmonizes the rules governing market makers and Members. Moreover, Members operating market makers would continue to be subject to federal and Exchange requirements for protecting material, non-public order information.¹⁸ The Exchange believes that the proposed rule change would remove impediments to and perfect the mechanism of a free and open market because it would harmonize the Exchange’s approach to protecting against the misuse of material, non-public information and no longer subject market makers to additional requirements. The Exchange does not believe that the existing requirements applicable to market makers are narrowly tailored to their respective roles because neither market participant has access to Exchange trading information in a manner different from any other market participant on the Exchange and they do not have agency responsibilities to the order book. Additionally, concerning Rule 717, the Exchange believes that appropriate information barriers can be used to demonstrate that the execution of two orders within one second was inadvertent because the orders were entered without knowledge of each other, will clarify the intent and application of Supplementary Material .06 to Rule 717.

The Exchange further believes the proposal is designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade because existing rules make clear to market makers and Members the type of conduct that is prohibited by the Exchange. While the proposal eliminates requirements relating to the misuse of material, non-public information, market makers and Members would remain subject to existing Exchange rules requiring them to establish and maintain systems to supervise their activities, and to create, implement, and maintain written procedures that are reasonably designed to comply with

¹⁸ See 15 U.S.C. 78o(g) and Rule 408(a).

applicable securities laws and Exchange rules, including the prohibition on the misuse of material, non-public information.

The Exchange notes that the proposed rule change would still require that Members operating market makers maintain and enforce policies and procedures reasonably designed to ensure compliance with applicable federal securities laws and regulations and with Exchange rules. Even though there would no longer be pre-approval of market maker information barriers, any market maker's written policies and procedures would continue to be subject to oversight by the Exchange and therefore the elimination of prescribed restrictions should not reduce the effectiveness of the Exchange rules to protect against the misuse of material, non-public information. Rather, Members will be able to utilize a flexible, principles-based approach to modify their policies and procedures as appropriate to reflect changes to their business model, business activities, or to the securities market itself. Moreover, while specified information barriers may no longer be required, a Member's business model or business activities may dictate that an information barrier or functional separation be part of the set of policies and procedures that would be reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable Exchange rules. The Exchange therefore believes that the proposed rule change will maintain the existing protection of investors and the public interest that is currently applicable to market makers, while at the same time removing impediments to and perfecting a free and open market by moving to a principles-based approach to protect against the misuse of material non-public information.

Finally, the Exchange believes that proposed rule change to Rule 717 is consistent with Section 6(b)(5) of the Act,¹⁹ which requires the rules of an exchange to prevent fraudulent and

¹⁹ 15 U.S.C. 78f(b)(5).

manipulative acts and practices, promote just and equitable principles of trade, remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and, in general, protect investors and the public interest. In particular, by continuing to specify that the information barriers must be fully documented, members will be better prepared to properly respond to requests for information by the Exchange in the course of a regulatory investigation. Moreover, while members are generally required to provide information to the Exchange as requested, continuing to specify that members must provide written documentation regarding information barriers within the context of this rule will assure that all members adhere to the existing standard for demonstrating compliance with the rule.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. To the contrary, the Exchange believes that the proposal will enhance competition by allowing market makers to comply with applicable Exchange rules in a manner best suited to their business models, business activities, and the securities markets, thus reducing regulatory burdens while still ensuring compliance with applicable securities laws and regulations and Exchange rules. The Exchange believes that the proposal will foster a fair and orderly marketplace without being overly burdensome upon market makers.

Moreover, the Exchange believes that the proposed rule change would eliminate a burden on competition for Members which currently exists as a result of disparate rule treatment between the options and equities markets regarding how to protect against the misuse of material, non-public information. For those Members that are also members of equity exchanges, their respective equity market maker operations are now subject to a principles-based

approach to protecting against the misuse of material non-public information.²⁰ The Exchange believes it would remove a burden on competition to enable Members to similarly apply a principles-based approach to protecting against the misuse of material, non-public information in the options space. To this end, the Exchange notes that Rule 408(a) still requires a Member that operates as a market maker on the Exchange to evaluate its business to assure that its policies and procedures are reasonably designed to protect against the misuse of material, non-public information. However, with this proposed rule change, a Member that trades equities and options could look at its firm more holistically to structure its operations in a manner that provides it with better tools to manage its risks across multiple security classes, while at the same time protecting against the misuse of material non-public information.

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 written comments from members or other interested parties.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

²⁰ See Securities Exchange Act Release Nos. 60604 (Sept. 2, 2009), 76 FR 46272 (Sept. 8, 2009) (SR-NYSEArca-2009-78) (Order approving elimination of NYSE Arca rule that required market makers to establish and maintain specifically prescribed information barriers, including discussion of NYSE Arca and Nasdaq rules) ("Arca Approval Order"); 61574 (Feb. 23, 2010), 75 FR 9455 (Mar. 2, 2010) (SR-BATS-2010-003) (Order approving amendments to BATS Rule 5.5 to move to a principles-based approach to protecting against the misuse of material, non-public information, and noting that the proposed change is consistent with the approaches of NYSE Arca and Nasdaq) ("BATS Approval Order"); and 72534 (July 3, 2014), 79 FR 39440 (July 10, 2014), SR-NYSE-2014-12) (Order approving amendments to NYSE Rule 98 governing designated market makers to move to a principles-based approach to prohibit the misuse of material non-public information) ("NYSE Approval Order").

The Exchange believes that the foregoing proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder because the foregoing proposed rule change does not (i) significantly affect the protection of investors or the public interest, (ii) impose any significant burden on competition, and (iii) become operative for 30 days after its filing date, or such shorter time as the Commission may designate.

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.

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 Gemini-2015-14 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE Gemini-2015-14. 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 will also 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 Gemini-2015-14 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.²¹

Robert W. Errett
Deputy Secretary
[FR Doc. 2015-22493 Filed: 9/4/2015 08:45
am; Publication Date: 9/8/2015]

²¹ 17 CFR 200.30-3(a)(12).