



8011-01P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-76998; File No. 10-221]

In the Matter of the Application of ISE Mercury, LLC for Registration as a National Securities Exchange; Findings, Opinion, and Order of the Commission

January 29, 2016

I. Introduction

On September 29, 2014, ISE Mercury, LLC (“ISE Mercury” or “Exchange”) submitted to the Securities and Exchange Commission (“Commission”) an Application for Registration as a National Securities Exchange (“Form 1 Application”)<sup>1</sup> under Section 6 of the Securities Exchange Act of 1934 (“Act”).<sup>2</sup> On June 26, 2015, ISE Mercury submitted Amendment No. 1 to its Form 1 Application.<sup>3</sup> Notice of the Form 1 Application, as modified by Amendment No. 1,

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<sup>1</sup> ISE Mercury, in conjunction with its submission of the Form 1 Application, requested an exemption under Section 36(a)(1) of the Act from certain requirements of Rules 6a-1(a) and 6a-2 of the Act. On September 9, 2015, the Commission issued an order granting ISE Mercury exemptive relief, subject to certain conditions, in connection with the filing of its Form 1 Application. See Securities Exchange Act Release No. 75867 (September 9, 2015), 80 FR 55395 (September 15, 2015). Because the Form 1 Application was not considered filed without the exemptive relief, the date of filing of such application is September 9, 2015. Id.

<sup>2</sup> 15 U.S.C. 78f.

<sup>3</sup> Amendment No. 1, among other things, includes changes to the Limited Liability Company Agreement of ISE Mercury (“ISE Mercury LLC Agreement”) and the Constitution of ISE Mercury (“ISE Mercury Constitution”) concerning board composition and fair representation of the Exchange’s members, use of confidential information for non-regulatory purposes, and the use of regulatory funds. Amendment No. 1 also includes revisions to the proposed rules of ISE Mercury. Amendment No. 1 further provides additional descriptions in Exhibit E to the Form 1 Application regarding ISE Mercury’s compliance with Regulation Systems Compliance and Integrity (“Regulation SCI”).

was published for comment in the Federal Register on September 16, 2015.<sup>4</sup> The Commission received one comment letter regarding the Form 1 Application.<sup>5</sup> ISE Mercury submitted a response to comments on December 7, 2015.<sup>6</sup> On January 8, 2016, ISE Mercury submitted Amendment No. 2 to the Form 1 Application.<sup>7</sup>

## II. Discussion

Under Sections 6(b) and 19(a) of the Act,<sup>8</sup> the Commission shall by order grant an application for registration as a national securities exchange if the Commission finds, among other things, that the proposed exchange is so organized and has the capacity to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.

As discussed in greater detail below, the Commission finds, after consideration of the comment letter and the Exchange's response thereto, that ISE Mercury's application for exchange registration meets the requirements of the Act and the rules and regulations thereunder.

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<sup>4</sup> See Securities Exchange Act Release No. 75884 (September 10, 2015), 80 FR 55691 ("Notice").

<sup>5</sup> See Letter from Kurt Eckert, Principal, Wolverine Trading, LLC ("Wolverine"), to Elizabeth M. Murphy, Secretary, Commission, dated October 23, 2014 ("Wolverine Letter").

<sup>6</sup> See Letter from Michael Simon, General Counsel and Secretary, ISE Mercury, to Brent J. Fields, Secretary, Commission, dated December 7, 2015 ("ISE Mercury Response Letter").

<sup>7</sup> Amendment No. 2, among other things, also includes revisions to the proposed rules of ISE Mercury to reflect changes to comparable ISE rules since the filing of Amendment No. 1. The changes proposed in Amendment No. 2 are not substantive, are consistent with the existing rules of other registered national securities exchanges, and do not raise any new or novel regulatory issues.

<sup>8</sup> 15 U.S.C. 78f(b) and 15 U.S.C. 78s(a), respectively.

Further, the Commission finds that the proposed rules of ISE Mercury are consistent with Section 6 of the Act in that, among other things, they assure a fair representation of the Exchange’s members in the selection of its directors and administration of its affairs and provide that one or more directors will be representative of issuers and investors and not be associated with a member of the exchange, or with a broker or dealer;<sup>9</sup> and that they are designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, protect investors and the public interest and are not designed to permit unfair discrimination between customers, issuers, or broker-dealers.<sup>10</sup> Finally, the Commission finds that ISE Mercury’s proposed rules do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>11</sup>

A. Overview of Ownership of ISE Mercury

ISE Mercury is structured as a Delaware limited liability company (“LLC”) and is a wholly-owned subsidiary of International Securities Exchange Holdings, Inc. (“ISE Holdings”).<sup>12</sup> ISE Holdings, in turn, is a wholly-owned subsidiary of U.S. Exchange Holdings, Inc. (“U.S. Exchange Holdings”), which is wholly-owned by Eurex Frankfurt AG, a German

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<sup>9</sup> See 15 U.S.C. 78f(b)(3).

<sup>10</sup> See 15 U.S.C. 78f(b)(5).

<sup>11</sup> See 15 U.S.C. 78f(b)(8).

<sup>12</sup> Following any Commission grant of registration to ISE Mercury, ISE Holdings will be the sole holding company of three registered national securities exchanges: International Securities Exchange LLC (“ISE”), ISE Gemini Exchange, LLC (“ISE Gemini”), and ISE Mercury. See Exhibit C to the Form 1 Application, Section M.

stock corporation (“Eurex Frankfurt”), and Deutsche Börse AG (“Deutsche Börse,” and together with U.S. Exchange Holdings and Eurex Frankfurt, the “Upstream Owners”).<sup>13</sup>

B. Governance of ISE Mercury

1. ISE Mercury Board of Directors

The board of directors of ISE Mercury (“ISE Mercury Board” or “Board”) will be its governing body and will possess all of the powers necessary for the management of its business and affairs, including governance of ISE Mercury as a self-regulatory organization (“SRO”).<sup>14</sup> The ISE Mercury Board will be comprised of no fewer than eight, but no more than 16, directors.<sup>15</sup> Specifically, at least 50% of the ISE Mercury Board must be comprised of Non-Industry Directors,<sup>16</sup> of which at least one of the Non-Industry Directors must be a Public

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<sup>13</sup> Eurex Frankfurt holds an 85% interest in U.S. Exchange Holdings, and Deutsche Börse holds the remaining 15%. In turn, Deutsche Börse holds a 100% interest in Eurex Frankfurt. The current upstream ownership structure of ISE Mercury is the result of the acquisition of ISE Holdings by Eurex Frankfurt in 2007 (the “Eurex Acquisition”)<sup>13</sup> and a corporate reorganizations in 2014.<sup>13</sup> See Securities Exchange Act Release No. 56955 (December 13, 2007), 72 FR 71979 (December 19, 2007) (File No. SR-ISE-2007-101) (order approving a transaction in which ISE Holdings became a wholly-owned indirect subsidiary of Eurex Frankfurt) (“Eurex Acquisition Order”); and Securities Exchange Act Release Nos. 73530 (November 5, 2014), 79 FR 67224 (November 12, 2014) (SR-ISE-2014-44); 73860 (December 17, 2014), 79 FR 77066 (December 23, 2014); 73531 (November 5, 2014), 79 FR 67215 (November 12, 2014) (SR-ISEGemini-2014-24); and 73861 (December 17, 2014), 79 FR 77064 (December 23, 2014).

<sup>14</sup> See ISE Mercury Constitution, Article III, Section 3.1.

<sup>15</sup> See ISE Mercury Constitution, Article III, Section 3.2(a).

<sup>16</sup> See ISE Mercury Constitution, Article III, Section 3.2(b)(ii). Under the ISE Mercury Constitution, “Non-Industry Director” means a member of ISE Mercury Board that meets the requirements of a non-industry representative and is elected by ISE Holdings. See id. “The term ‘non-industry representative’ means any person that is not considered an ‘industry representative,’ as well as (i) a person affiliated with a broker or dealer that operates solely to assist the securities-related activities of the business of non-member affiliates, (ii) an employee of an entity that is affiliated with a broker or dealer that does not account for a material portion of the revenues of the consolidated entity, and who is primarily engaged in the business of the non-member entity.” ISE Mercury Constitution,

Director.<sup>17</sup> Further, the ISE Mercury Board will include the President/Chief Executive Officer as a director.<sup>18</sup> Moreover, at least 30% of the ISE Mercury Board must be officers, directors or partners of ISE Mercury members, and must be elected by a plurality of holders of Exchange Rights<sup>19</sup> (“Industry Directors”), of which at least: (i) one must be elected by a plurality of holders of Primary Market Maker (“PMM”) Exchange Rights, (ii) one must be elected by a plurality of holders of Competitive Market Maker (“CMM”) Exchange Rights, and (iii) one must be elected by a plurality of holders of Electronic Access Member (“EAM”) Exchange Rights, provided that the number of each type of Industry Director shall always be equal.<sup>20</sup>

As part of the process to elect members of the Board, the Nominating Committee will nominate the proposed Industry Directors and the Corporate Governance Committee<sup>21</sup> and ISE

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Article VIII, Section 13.1(v). The term “industry representative” means a person who is an officer, director or employee of a broker or dealer or who has been employed in any such capacity at any time within the prior three (3) years, as well as a person who has a consulting or employment relationship with or has provided professional services to the Exchange and a person who had any such relationship or provided any such services to the Exchange at any time within the prior three (3) years. See ISE Mercury Constitution, Article VIII, Section 13.1(s).

<sup>17</sup> See ISE Mercury Constitution, Article III, Section 3.2(b)(ii). Under the ISE Mercury Constitution, “Public Director” means a Non-Industry Director that is a non-industry representative who has no material relationship with a broker or dealer or any affiliate of a broker or dealer or the Exchange or any affiliate of the Exchange. See ISE Mercury Constitution, Article VIII, Sections 13.1(aa) and (bb), and Article III, Section 3.2(b)(ii).

<sup>18</sup> See ISE Mercury Constitution, Article III, Section 3.2(b)(iii).

<sup>19</sup> See ISE Mercury Rule 300 Series. “Exchange Rights” means the PMM Rights, CMM Rights and EAM Rights collectively. See ISE Mercury Rule 100(a)(17). PMM Rights, CMM Rights and EAM Rights have the meaning set forth in Article VI of ISE Mercury LLC Agreement. See ISE Mercury Rules 100(a)(12), 100(a)(15) and 100(a)(36).

<sup>20</sup> See ISE Mercury Constitution, Article III, Section 3.2(b)(i).

<sup>21</sup> See infra Section 0. for a description of ISE Mercury’s Nominating Committee and Corporate Governance Committee.

Holdings will nominate the proposed Non-Industry Directors.<sup>22</sup> A petition process will allow ISE Mercury members to nominate alternate candidates for consideration as Industry Directors.<sup>23</sup> At the first annual meeting and at each annual meeting thereafter, ISE Holdings will elect all of the members of the ISE Mercury Board (except the Industry Directors, which are elected by ISE Mercury members<sup>24</sup>) but will be required to do so in compliance with the compositional requirements for the Board outlined in the ISE Mercury Constitution.

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<sup>22</sup> See, e.g., ISE Mercury Constitution, Article III, Section 3.10(a)-(b). ISE Holdings, as the Sole LLC Member of ISE Mercury, is permitted to petition the Corporate Governance Committee to propose alternate Non-Industry Directors and Public Directors. See ISE Mercury Constitution, Article III, Section 3.10(b)(ii). See also infra note 63 for a definition of “Sole LLC Member.”

<sup>23</sup> See, e.g., ISE Mercury Constitution, Article III, Section 3.10(a)(ii). Specifically, in addition to the Industry Director nominees named by the Nominating Committee, persons eligible to serve as such may be nominated for election to the ISE Mercury Board by a petition, signed by the holders of not less than five percent (5%) of the outstanding Exchange Rights of the series entitled to elect such person if there are more than eighty (80) Exchange Rights in the series entitled to vote, ten percent (10%) of the outstanding rights of such series entitled to elect such person if there are between eighty (80) and forty (40) Exchange Rights in the series entitled to vote, and twenty-five percent (25%) of the outstanding Exchange Rights of such series entitled to elect such person if there are less than forty (40) Exchange Rights in the series entitled to vote. For purposes of determining whether a person has been nominated for election by petition by the requisite percentage, no ISE Mercury member, alone or together with its affiliates, may account for more than 50% of the signatures of the holders of outstanding Exchange Rights of the series entitled to elect such person, and any such signatures by such Exchange Members, alone or together with its affiliates, in excess of such 50% limitation shall be disregarded. Id. This process is identical to the process in place at ISE. See ISE Second and Amended Constitution, Article III, Section 3.10(a)(ii).

<sup>24</sup> See ISE Mercury Constitution, Article III, Sections 3.2(b)(i) and (c).

The Commission notes that pursuant to Section 6.3(b) of the ISE Mercury LLC Agreement, a holder of Exchange Rights, together with any affiliate, as such term is defined in the ISE Mercury Constitution, may not exercise the voting rights associated with more than twenty percent (20%) of the outstanding Exchange Rights. Any exercise of voting rights in excess of twenty percent (20%) of the outstanding Exchange Rights by a holder of Exchange Rights, together with any affiliate, shall be deemed null and void. See Exhibit J.2 to the Form 1 Application.

The Commission believes that the requirements in the ISE Mercury Constitution – that at least 30% of the directors be Industry Directors and the means by which they will be chosen by ISE Mercury members<sup>25</sup> – are consistent with Section 6(b)(3) of the Act because they provide for the fair representation of members in the selection of directors and the administration of ISE Mercury.<sup>26</sup> Section 6(b)(3) of the Act requires that “the rules of the exchange assure a fair representation of its members in the selection of its directors and administration of its affairs and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer.” As the Commission previously has noted, this statutory requirement helps to ensure that members have a voice in the Exchange’s use of self-regulatory authority and that the Exchange is administered in a way that is equitable to all those persons who trade on its market or through its facilities.<sup>27</sup> In addition, the Commission believes that the requirements that at least 50% of the Board be composed of Non-Industry Directors and that at least one director be a Public Director satisfy the requirements of Section 6(b)(3) of the Act.<sup>28</sup>

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<sup>25</sup> Id. See also ISE Mercury Constitution, Article III, Section 3.10(a)(ii).

<sup>26</sup> 15 U.S.C. 78f(b)(3).

<sup>27</sup> See, e.g., Securities Exchange Act Release Nos. 70050 (July 26, 2013), 78 FR 46622 (August 1, 2013) (File No. 10-209) (order granting the exchange registration of ISE Gemini (“ISE Gemini Order”)); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131) (order granting the exchange registration of Nasdaq Stock Market, Inc.) (“Nasdaq Order”); and 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) (order granting the exchange registration of BATS Exchange, Inc.) (“BATS Order”).

<sup>28</sup> 15 U.S.C. 78f(b)(3). See also ISE Gemini Order, supra note 27; Securities Exchange Act Release No. 68341, p.8, (December 3, 2012), 77 FR 73065, 73067 (December 7, 2012) (File No. 10-207) (order granting the registration of Miami International Securities Exchange, LLC) (“MIAX Order”); and Regulation of Exchanges and Alternative Trading Systems, Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (“Regulation ATS Release”).

## 2. Interim Board

After ISE Mercury is granted registration by the Commission, but prior to commencing operations, ISE Holdings, as the sole shareholder of ISE Mercury,<sup>29</sup> will appoint an interim board of directors for ISE Mercury that will serve only until the first annual meeting (“Interim ISE Mercury Board”). The Interim ISE Mercury Board will be comprised of the same individuals as those then-serving ISE board and ISE Gemini board and will consist of 15 directors: the President/Chief Executive Officer Director,<sup>30</sup> six Industry Directors; and eight Non-Industry Directors.<sup>31</sup> ISE Mercury anticipates that there will be a significant overlap between its membership and the membership of ISE and ISE Gemini.<sup>32</sup> ISE Mercury also “does not expect to receive a meaningful number of applications for membership from non-ISE and ISE Gemini members during the tenure of the Interim ISE Mercury Board.”<sup>33</sup> Thus, the six interim Industry Directors to be appointed to the ISE Mercury Board likely will have been elected by ISE Mercury members in their capacity as ISE and ISE Gemini members.<sup>34</sup>

These interim Industry Directors will serve until the first initial ISE Mercury Board is elected pursuant to the full nomination, petition, and voting process set forth in the ISE Mercury

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<sup>29</sup> See infra Section 0. for a discussion of the ownership of ISE Mercury.

<sup>30</sup> See Exhibit J to the Form 1 Application.

<sup>31</sup> See Exhibit J to the Form 1 Application.

<sup>32</sup> See Exhibit L to the Form 1 Application. Based on discussions with ISE members, ISE Mercury represented that it currently expects that ISE Mercury’s membership will consist substantially of current ISE and ISE Gemini members, including, but not limited to, those ISE and ISE Gemini members that have representatives serving as industry directors on the ISE Board. See Exhibit J to ISE Mercury Form 1 Application.

<sup>33</sup> Exhibit J to the Form 1 Application.

<sup>34</sup> See id.

Constitution as described above.<sup>35</sup> ISE Mercury will complete such process as promptly as possible and within 90 days after its application for registration as a national securities exchange is granted by the Commission.<sup>36</sup>

The Commission believes that the process for electing the Interim ISE Mercury Board, as proposed, is consistent with the requirements of the Act, including that the rules of the exchange assure fair representation of the exchange's members in the selection of its directors and administration of its affairs.<sup>37</sup> The Commission believes that the Interim ISE Mercury Board process is designed to provide member representation sufficient to allow ISE Mercury to commence operations for an interim period prior to going through the process to elect a new Board pursuant to the full nomination, petition, and voting process set forth in the ISE Mercury Constitution.

The Interim ISE Mercury Board will be filled by current ISE and ISE Gemini Board members (which currently include Industry Directors who were elected by current ISE and ISE Gemini members) until the first annual meeting of ISE Mercury.<sup>38</sup> As noted above, ISE Mercury anticipates that there will be significant overlap between the initial members of ISE Mercury and

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<sup>35</sup> See ISE Mercury Constitution, Article III, Sections 3.2(c) and 3.10; see also Exhibit J to the Form 1 Application.

<sup>36</sup> See Exhibit J to the Form 1 Application.

<sup>37</sup> See 15 U.S.C. 78f(b)(3). ISE Mercury's proposed timeline for the Interim ISE Mercury Board process comports with the interim board process approved by the Commission for ISE Gemini, the Boston Options Exchange ("BOX") and Miami International Securities Exchange, LLC ("MIAX"). See ISE Gemini Order, supra note at 27; Securities Exchange Act Release No. 66871 (April 27, 2012), 77 FR 26323 (May 3, 2012) (File No. 10-206) ("BOX Order"); and the MIAX Order, supra note 28.

<sup>38</sup> See Exhibit J to the Form 1 Application.

the current members of ISE and ISE Gemini.<sup>39</sup> Moreover, ISE Mercury will complete the full nomination, petition, and voting process, as set forth in the ISE Mercury Constitution,<sup>40</sup> as promptly as possible and within 90 days of when ISE Mercury's application for registration as a national securities exchange is granted.<sup>41</sup> As a part of the full nomination, petition, and voting process, members of ISE Mercury will be able to petition for alternate candidates to be considered for Industry Director positions.<sup>42</sup> This process will provide persons who are approved as members of ISE Mercury after the effective date of this order with the opportunity to participate in the selection of the Industry Directors.

### 3. Exchange Committees

ISE Mercury will have a number of Board committees,<sup>43</sup> including an Executive Committee (consisting of six directors, and with the number of Non-Industry Directors equaling or exceeding the number of Industry Directors),<sup>44</sup> a Finance and Audit Committee (consisting of between three and five directors, all of whom must be Non-Industry Directors),<sup>45</sup> a Compensation Committee (consisting of between three and five directors, all of whom must be

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<sup>39</sup> ISE Mercury will have a streamlined waive-in process for existing ISE and ISE Gemini members to apply for membership on ISE Mercury. See ISE Mercury Rule 302(a).

<sup>40</sup> See, e.g., ISE Mercury Constitution, Article III, Section 3.10(a)-(b).

<sup>41</sup> See ISE Mercury Constitution, Article III, Sections 3.2(c) and 3.10.

<sup>42</sup> See ISE Mercury Constitution, Article III, Section 3.10(a)(ii).

<sup>43</sup> See ISE Mercury Constitution, Article V, Section 5.1(a).

<sup>44</sup> See ISE Mercury Constitution, Article V, Section 5.2. The Executive Committee will have and may exercise all the powers and authority of the Board, except that the Executive Committee will not have the powers of the Board with respect to approving: (i) any merger, consolidation, sale of substantially all of the assets or dissolution of the Exchange; or (ii) any matters pertaining to the self-regulatory function of the Exchange or relating to the structure of the market which the Exchange regulates. See id.

<sup>45</sup> See ISE Mercury Constitution, Article V, Section 5.5.

Non-Industry Directors),<sup>46</sup> a Corporate Governance Committee (consisting of at least three directors, all of whom must be Non-Industry Directors),<sup>47</sup> and such other additional committees as may be approved by the ISE Mercury Board.<sup>48</sup>

ISE Mercury also will have a Nominating Committee, which will be a committee of ISE Mercury and not a committee of the Board.<sup>49</sup> The Nominating Committee will be composed of three Exchange Member Representatives<sup>50</sup> and will be responsible for nominating candidates for Industry Director positions.<sup>51</sup> As noted above, there will be a petition process by which members of ISE Mercury can nominate their own nominees for the Industry Director positions.<sup>52</sup> These nomination processes are consistent with processes that the Commission has approved for other national securities exchanges.<sup>53</sup>

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<sup>46</sup> See ISE Mercury Constitution, Article V, Section 5.6.

<sup>47</sup> See ISE Mercury Constitution, Article V, Section 5.4.

<sup>48</sup> See ISE Mercury Constitution, Article V, Section 5.1(a).

<sup>49</sup> See ISE Mercury Constitution, Article V, Section 5.3.

<sup>50</sup> See id. Article XIII, Section 13.1(n) of the ISE Mercury Constitution defines “Exchange Member Representative” as an associated person of an Exchange Member, and Section 13.1(m) defines “Exchange Member” as an organization that has been approved to exercise trading rights associated with Exchange Rights.

<sup>51</sup> See ISE Mercury Constitution, Article V, Section 5.3. The Interim ISE Mercury Board shall appoint the initial members of the Nominating Committee in accordance with the qualifications prescribed in Section 5.3 of the ISE Mercury Constitution.

<sup>52</sup> See ISE Mercury Constitution, Article III, Section 3.10(a)(ii). See also supra note 23 and accompanying text.

<sup>53</sup> See, e.g., ISE Second Amended and Restated Constitution, Articles III and V, Sections 3.10 and 5.3; ISE Gemini Constitution, Articles III and V, Sections 3.10 and 5.3; and MIAX Amended and Restated By-laws, Articles II and V, Sections 2.4 and 5.3.

The Commission believes that ISE Mercury's proposed committees, which are similar to committees maintained by other national securities exchanges,<sup>54</sup> are designed to help enable ISE Mercury to carry out its responsibilities under the Act and are consistent with the Act, including Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>55</sup>

C. Regulation of ISE Mercury

When ISE Mercury commences operations as a national securities exchange, it will have all the attendant regulatory obligations under the Act. In particular, ISE Mercury will be responsible for the operation and regulation of its trading system and the regulation of its members. Certain provisions in the ISE Mercury's and ISE Holdings' governance documents are designed to facilitate the ability of ISE Mercury and the Commission to fulfill their regulatory and oversight obligations under the Act. The discussion below summarizes some of these key provisions.

1. Ownership Structure: Ownership and Voting Limitations

As noted above in Section II.A, ISE Mercury is a Delaware LLC and a wholly-owned subsidiary of ISE Holdings.<sup>56</sup> ISE Holdings is owned by Eurex Frankfurt and Deutsche Börse through an intermediary holding company, U.S. Exchange Holdings. ISE Holdings' governing

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<sup>54</sup> See, e.g., ISE Gemini Order, supra note 27, MIAX Order, supra note 28, and BOX Order, supra note 37.

<sup>55</sup> 15 U.S.C. 78f(b)(1).

<sup>56</sup> The ISE Mercury LLC Agreement provides that ISE Holdings may not assign its interest in ISE Mercury unless such assignment is subject to prior approval by the Commission pursuant to the rule filing procedure under Section 19 of the Act. See ISE Mercury LLC Agreement, Section 7.1 (Assignments; Additional LLC Members).

documents impose limits on any direct or indirect change in control of ISE Holdings, which are to be enforced through the creation of a statutory trust.<sup>57</sup>

Specifically, ISE Holdings' governing documents prohibit any ISE Mercury member (alone or together with its Related Persons<sup>58</sup>) from owning more than 20% of any class of Voting Shares of ISE Holdings.<sup>59</sup> Moreover, pursuant to ISE Holdings' governing documents, no person (alone or together with its Related Persons) may own more than 40% of any class of Voting Shares of ISE Holdings.<sup>60</sup> Finally, no person (alone or together with its Related Persons) may vote or cause the voting of shares representing more than 20% of the voting power of the then outstanding Voting Shares of ISE Holdings.<sup>61</sup> As described more fully below, if a person exceeds an ISE Holdings' ownership or voting limit, a majority of the capital stock of ISE Holdings that has the right by its terms to vote in the election of the ISE Holdings Board or on

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<sup>57</sup> See Article FOURTH, Section III.(c) of the Second Amended and Restated Certificate of Incorporation of International Securities Exchange Holdings, Inc. ("ISE Holdings Certificate"). See *infra* notes 67-69 and 101-105 and accompanying text for a discussion of the statutory trust.

<sup>58</sup> See ISE Holdings Certificate, Article FOURTH, Section III for the definition of "Related Persons."

<sup>59</sup> See ISE Holdings Certificate, Article FOURTH, Section III.(a)(i) for the definition of "Voting Shares." The ISE Holdings Certificate defines "Voting Shares" as shares of the capital stock (whether Common Stock or Preferred Stock) of the ISE Holdings that have the right by their terms to vote in the election of members of the ISE Holdings board of directors ("ISE Holdings Board") or on other matters which may require the approval of the holders of voting shares of the ISE Holdings (other than matters affecting the rights, preferences or privileges of a particular class of capital stock).

<sup>60</sup> See ISE Holdings Certificate, Article FOURTH, Section III.(a)(i).

<sup>61</sup> See ISE Holdings Certificate, Article FOURTH, Section III.(b). See also Second Amended and Restated Bylaws of ISE Holdings ("ISE Holdings Bylaws"), Article XI, Section 11.1(b).

other matters (other than matters affecting the rights, preferences or privileges of the capital stock) automatically will be transferred to a Delaware statutory trust (“ISE Trust”).<sup>62</sup>

The ISE Mercury LLC Agreement and ISE Mercury Constitution do not include change of control provisions that are similar to those in the ISE Holdings Certificate and ISE Holdings

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<sup>62</sup> See ISE Holdings Certificate, Article FOURTH, Section III.(c). See also *infra* notes 67-70 and accompanying text for a discussion of the ISE Trust.

Consistent with the governance structure of other exchanges, however, ISE Holdings Board may waive the 40% ownership limitation and the 20% voting restriction for persons other than ISE Mercury members, subject to certain specified conditions, but such waiver will not be effective unless approved by the Commission. Specifically, The ISE Holdings Certificate allows the ISE Holdings Board to waive the ISE Holdings ownership and voting limits pursuant to an amendment to the ISE Holdings Bylaws, provided that the ISE Holdings Board makes certain determinations. See ISE Holdings Certificate, Article FOURTH, Sections III.(a)(i)(A), III.(a)(i)(B) and III.(b)(i).

Article XI of the ISE Holdings Bylaws waives the ISE Holdings ownership and voting limits to allow the Upstream Owners to own and vote all of the common stock of ISE Holdings. Article XI, Section 11.1(b) states that, in waiving the ISE Holdings ownership and voting limits to permit the Upstream Owners to own and vote the capital stock of ISE Holdings, the ISE Holdings Board has determined, with respect to each Upstream Owner, that: (i) such waiver will not impair the ability of ISE Holdings and each “Controlled National Securities Exchange” (*i.e.*, any national securities exchange or facility thereof controlled, directly or indirectly, by ISE Holdings, including ISE, ISE Gemini, and as a result of this order, ISE Mercury) to carry out their respective functions and responsibilities under the Act; (ii) such waiver is in the best interests of ISE Holdings, its stockholders, and each Controlled National Securities Exchange; (iii) such waiver will not impair the ability of the Commission to enforce the Act; (iv) neither the Upstream Owner nor any of its related persons is subject to a statutory disqualification (within the meaning of Section 3(a)(39) of the Act, 15 U.S.C. 78c(a)(39)); and (v) neither the Upstream Owner nor any of its related persons is a member of such Controlled National Securities Exchange. Article XI of the ISE Holdings Bylaws was adopted in connection with the Eurex Acquisition, when ISE was the sole national securities exchange controlled by ISE Holdings. See Eurex Acquisition Order, *supra* note 13. Article XI, Section 11.1(b) was subsequently amended to apply to any Controlled National Securities Exchange, which by its terms will include ISE Mercury. See Securities Exchange Act Release No. 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (order approving proposed rule change relating to the purchase by ISE Holdings of an ownership interest in Direct Edge Holdings, Inc.) and 61498 (February 4, 2010), 75 FR 7299 (February 18, 2010) (order approving proposed rule change relating to changes to the U.S. Exchange Holdings corporate documents and ISE Trust).

Bylaws. However, the ISE Mercury LLC Agreement and the ISE Mercury Constitution explicitly provide that ISE Holdings is the Sole LLC Member of ISE Mercury.<sup>63</sup> Under the ISE Mercury LLC Agreement, ISE Holdings is permitted to “assign all (but not less than all)” of its interest in ISE Mercury, but the assignment of all of ISE Holdings’ interest in ISE Mercury will be subject to prior approval by the Commission pursuant to the rule filing procedures under Section 19 of the Act.<sup>64</sup>

To facilitate compliance with the ISE Holdings ownership and voting limits, the Upstream Owners have committed to take reasonable steps necessary to cause ISE Holdings to be in compliance with the ISE Holdings ownership and voting limits. These commitments are contained in the governing documents for U.S. Exchange Holdings<sup>65</sup> and in corporate resolutions for Eurex Frankfurt and Deutsche Börse.<sup>66</sup>

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<sup>63</sup> See ISE Mercury LLC Agreement, Article II, Section 2.1 and ISE Mercury Constitution Article I, Section 1.1 (both of which define “Sole LLC Member” to mean ISE Holdings, as the sole member of ISE Mercury).

<sup>64</sup> See 15 U.S.C. 78s; see also ISE Mercury LLC Agreement, Article VII, Section 7.1 and ISE Mercury Constitution, Article I, Section 1.1.

<sup>65</sup> The Third Amended and Restated Certificate of Incorporation of U.S. Exchange Holdings (“U.S. Exchange Holdings Certificate”) provides that, for so long as U.S. Exchange Holdings directly or indirectly controls a Controlled National Securities Exchange, U.S. Exchange Holdings will take reasonable steps necessary to cause ISE Holdings to be in compliance with the ISE Holdings’ ownership and voting limits. See U.S. Exchange Holdings Certificate, Article THIRTEENTH.

<sup>66</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Section (4)), Exhibit B to the Form 1 Application. In the Form 1 Application, ISE Mercury included these supplemental resolutions that Eurex Frankfurt and Deutsche Börse have each adopted that, in part, incorporate provisions regarding the ownership and voting limits (“ISE Mercury Resolutions”) in the same manner and to the same extent as prior corporate resolutions signed by Eurex Frankfurt and Deutsche Börse apply to ISE and ISE Gemini (“2007 Resolutions”). The ISE Mercury Resolutions were signed by Eurex Frankfurt and Deutsche Börse, and extend to ISE Mercury the commitments made in the 2007 Resolutions with respect to ISE and ISE Gemini. For example, ISE Mercury represented in Exhibit B of Amendment No. 2 to the Form 1 Application that the

In connection with the Eurex Acquisition, ISE implemented the ISE Trust pursuant to a Trust Agreement (“2007 Trust Agreement”) among ISE Holdings, U.S. Exchange Holdings, trustees (“Trustees”), and a Delaware trustee, which agreement has been subsequently amended to take into account subsequent acquisitions, including the current transaction.<sup>67</sup> The ISE Trust Agreement serves, in part, to effectuate the ownership and voting limits for ISE Holdings in the event that a person obtains an ownership or voting interest in excess of the limits established in the ISE Holdings Certificate without prior Commission approval. To accomplish that purpose, for as long as ISE Holdings controls, directly or indirectly, a national securities exchange, including ISE Mercury, the ISE Trust would accept, hold and dispose of Trust Shares<sup>68</sup> on the

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Deutsche Börse AG Executive Board adopted its corporate resolution on February 17, 2015 and the Eurex Frankfurt Executive Board adopted its corporate resolutions on February 13, 2015.

<sup>67</sup> See Third Amended and Restated Trust Agreement, dated as of December 22, 2014, by and among ISE Holdings, U.S. Exchange Holdings, and the Trustees (“ISE Trust Agreement”). The term of the ISE Trust is perpetual, provided that ISE Holdings directly or indirectly controls a national securities exchange or a facility thereof, which would include ISE Mercury. See ISE Trust Agreement, Article III, Section 2.6(a). See also Eurex Acquisition Order, *supra* note 13, at Section II.C., for a more detailed description of the ISE Trust. By its terms, the 2007 Trust Agreement related solely to ISE Holdings’ ownership of ISE, and not to any other national securities exchange that ISE Holdings might control, directly or indirectly. In 2010, the Commission approved proposed rule changes that revised the 2007 Trust Agreement to replace references to ISE with references to any Controlled National Securities Exchange. See Securities Exchange Act Release Nos. 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (“ISE Holdings Order”) and 61498 (February 4, 2010), 75 FR 7299 (February 18, 2010) (“U.S. Exchange Holdings Order”); see also ISE Trust Agreement, Articles I and II, Sections 1.1 and 2.6. Thus, the ISE Trust Agreement also applies to ISE Gemini and will apply to ISE Mercury, upon the Commission granting ISE Mercury registration as a national securities exchange.

<sup>68</sup> Under the ISE Trust Agreement, the term “Trust Shares” means either Excess Shares or Deposited Shares, or both, as the case may be. The term “Excess Shares” means that a person obtained an ownership or voting interest in ISE Holdings in excess of the ownership and voting limits pursuant to Article FOURTH of the ISE Holdings Certificate, for example, through ownership of one of the Upstream Owners, without obtaining the approval of the Commission. The term “Deposited Shares” means shares

terms and subject to the conditions set forth therein.<sup>69</sup> Specifically, if any person's ownership percentage exceeds the ownership limits or any person's voting control percentage exceeds the voting limits without Commission approval, the Excess Shares will be transferred automatically to the ISE Trust pursuant to the terms prescribed in the ISE Holdings Certificate.<sup>70</sup> The ISE Trust then would accept the Excess Shares and hold them for the benefit of the trust beneficiary, U.S. Exchange Holdings, who has the right to reacquire the Excess Shares either when a person no longer exceeds the ownership or voting limits or when such excess ownership percentage or voting control percentage is approved by the Commission in accordance with ISE Holdings Certificate.<sup>71</sup>

Although ISE Holdings is not independently responsible for regulation of ISE Mercury, its activities with respect to the operation of ISE Mercury must be consistent with, and must not interfere with, the self-regulatory obligations of ISE Mercury.<sup>72</sup> As described above, the provisions applicable to direct and indirect changes in control of ISE Holdings and ISE

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that are transferred to the ISE Trust pursuant to the ISE Trust's exercise of the Call Option. Under the ISE Trust Agreement, the term "Call Option" means the option granted by the ISE Trust beneficiary to the ISE Trust to call the Voting Shares as set forth in Section 4.2 therein. See infra Section 0 for further discussion of the Call Option.

<sup>69</sup> See ISE Trust Agreement, Article IV, Section 4.1; see also ISE Holdings Certificate, Article FOURTH, Section III.(c); Eurex Acquisition Order, supra note 13, at 72 FR 71982 n.37 and accompanying text.

<sup>70</sup> See id.

<sup>71</sup> See ISE Trust Agreement, Article IV, Section 4.1(f). In addition, as discussed in Section 0 below, the Trust also may accept, hold and dispose of Trust Shares in connection with the Call Option. Section 4.2(h) of the ISE Trust Agreement governs when the Trustees can transfer Deposited Shares in connection with the Call Option. Section 4.3(a) of the ISE Trust Agreement further permits the Trustees, upon receipt of written instructions from the Trust Beneficiary, to sell Trust Shares to a person or persons whose ownership percentage or voting control percentage will not violate the ownership or voting limits.

<sup>72</sup> See also infra Section 0. (Regulatory Independence and Oversight).

Mercury, as well as the voting limitation, are designed to help prevent any owner of ISE Holdings from exercising undue influence or control over the operation of ISE Mercury and to help ensure that ISE Mercury is able to effectively carry out its regulatory obligations under the Act. In addition, these limitations are designed to address the conflicts of interests that might result from a member of a national securities exchange owning interests in the Exchange. As the Commission has noted in the past, however, a member's interest in an exchange, including an entity that controls an exchange, could become so large as to cast doubts on whether the exchange may fairly and objectively exercise its self-regulatory responsibilities with respect to such member.<sup>73</sup> A member that is a controlling shareholder of an exchange could seek to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and conduct surveillance of the member's conduct or diligently enforce the exchange's rules and the federal securities laws with respect to conduct by the member that violates such provisions. As such, these requirements are designed to minimize the potential that a person or entity can improperly interfere with or restrict the ability of ISE Mercury to effectively carry out its regulatory oversight responsibilities under the Act.

The Commission believes that ISE Mercury's and ISE Holdings' proposed ownership and voting limitation provisions, together with the provisions in U.S. Exchange Holdings' governing documents, the ISE Mercury Resolutions, and the ISE Trust Agreement described above,<sup>74</sup> are consistent with the Act, including Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>75</sup> In

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<sup>73</sup> See, e.g., ISE Gemini Order, supra note 27; and BATS Order, supra note 27; see also MIAX Order, supra note 28.

<sup>74</sup> See supra notes 65-66, and accompanying text.

<sup>75</sup> 15 U.S.C. 78f(b)(1).

particular, these requirements are designed to minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or ISE Mercury to effectively carry out their regulatory oversight responsibilities under the Act.<sup>76</sup>

2. Regulatory Independence and Oversight

a. ISE Holdings

Although ISE Holdings itself will not itself carry out regulatory functions, its activities with respect to the operation of ISE Mercury must be consistent with, and not interfere with, the self-regulatory obligations of ISE Mercury.<sup>77</sup> In this regard, ISE Mercury and ISE Holdings' respective corporate documents include certain provisions that are designed to maintain the independence of ISE Mercury's self-regulatory function. These provisions are substantially similar to those included in the governing documents of the exchanges that have most recently been granted registration.<sup>78</sup> Specifically:

- The directors, officers, and employees of ISE Holdings must give due regard to the preservation of the independence of the self-regulatory function of ISE Mercury and must not take actions that would interfere with the effectuation of decisions by the ISE Mercury Board relating to ISE Mercury's regulatory functions (including

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<sup>76</sup> In addition, the ISE Trust Agreement is consistent with the provisions that other entities that directly or indirectly own or control an SRO have instituted and that have been approved by the Commission. See, e.g., Securities Exchange Act Release No. 55293 (February 14, 2007), 72 FR 8033 (February 22, 2007) (File No. SR-NYSE-2006-120) (order relating to the combination between NYSE Group, Inc. and Euronext N.V.). See also Eurex Acquisition Order, supra note 13, at 72 FR 71986 n.111.

<sup>77</sup> See, e.g., ISE Gemini Order, supra note 27; and BOX Order, supra note 37.

<sup>78</sup> See, e.g., ISE Gemini Order, supra note 27; BOX Order, supra note 37; MIAX Order, supra note 28.

disciplinary matters) or that would adversely affect the ability of ISE Mercury to carry out its responsibilities under the Act.<sup>79</sup>

- ISE Holdings must comply with federal securities laws and the rules and regulations promulgated thereunder, and must cooperate with ISE Mercury and the Commission pursuant to, and to the extent of, their respective regulatory authority. In addition, ISE Holdings' officers, directors, and employees must comply with federal securities laws and the rules and regulations thereunder and agree to cooperate with ISE Mercury and the Commission pursuant to their respective regulatory authority.<sup>80</sup>
- ISE Holdings, and its officers, directors, employees, and agents are deemed to irrevocably submit to the jurisdiction of the U.S. federal courts, the Commission, and ISE Mercury, for purposes of any suit, action, or proceeding pursuant to U.S. federal securities laws, and the rules and regulations thereunder, arising out of, or relating to, ISE Mercury's activities.<sup>81</sup>

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<sup>79</sup> See ISE Holdings Bylaws, Article I, Section 1.5. Similarly, Article V, Section 5.1(b) of the ISE Mercury LLC Agreement requires each ISE Mercury Board director to take into consideration the effect that his or her actions would have on the ability of ISE Mercury to carry out its responsibilities under the Act and on the ability of ISE Mercury to engage in conduct that fosters and does not interfere with ISE Mercury's ability to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities or assist in the removal of impediments to or perfection of the mechanisms for a free and open market and a national market system; and in general to protect investors and the public interest.

<sup>80</sup> See ISE Holdings Certificate, Article TENTH. ISE Holdings also shall take reasonable steps necessary to cause its agents to cooperate with ISE Mercury and the Commission pursuant to their respective regulatory authority. ISE Holdings Certificate, Article THIRTEENTH.

<sup>81</sup> See ISE Holdings Bylaws, Article I, Section 1.4.

- All books and records of ISE Mercury containing confidential information pertaining to the self-regulatory function of ISE Mercury (including but not limited to confidential information regarding disciplinary matters, trading data, trading practices and audit information) will be subject to confidentiality restrictions.<sup>82</sup>
- The books and records of ISE Mercury and ISE Holdings must be maintained in the United States<sup>83</sup> and, to the extent they are related to the operation or administration of ISE Mercury, ISE Holdings books and records will be subject at all times to inspection and copying by the Commission.<sup>84</sup>
- Furthermore, to the extent that they are related to the activities of ISE Mercury, the books, records, premises, officers, directors, and employees of ISE Holdings will be deemed to be the books, records, premises, officers, directors, and employees of ISE Mercury, for purposes of, and subject to oversight pursuant to, the Act.<sup>85</sup>

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<sup>82</sup> See ISE Holdings Certificate, Article ELEVENTH. Additionally, pursuant to the ISE Mercury LLC Agreement, books and records of ISE Mercury containing confidential information pertaining to the self-regulatory function of ISE Mercury (including but not limited to confidential information regarding disciplinary matters, trading data, trading practices and audit information) shall be retained in confidence by ISE Mercury and its officers, directors, employees and agents and will not be used by ISE Mercury for any non-regulatory purpose and shall not be made available to persons other than those officers, directors, employees and agents that have a reasonable need to know the contents thereof. See ISE Mercury LLC Agreement, Article VI, Section 4.1(b). The requirement to keep such information confidential shall not limit or impede the Commission's ability to access and examine such information or limit or impede the ability of officers, directors, employees, or agents of ISE Holdings to disclose such information to the Commission. See ISE Holdings Certificate, Article ELEVENTH and ISE Mercury LLC Agreement, Article VI, Section 4.1(b).

<sup>83</sup> See ISE Mercury LLC Agreement, Article IV, Section 4.1 and ISE Holdings Bylaws, Article I, Section 1.3.

<sup>84</sup> See ISE Holdings Certificate, Article TWELFTH.

<sup>85</sup> See id.

- ISE Holdings will take necessary steps to cause its officers, directors, and employees, prior to accepting a position as an officer, director, or employee (as applicable) to consent in writing to the applicability of provisions regarding books and records, confidentiality, jurisdiction, and regulatory obligations, with respect to their activities related to ISE Mercury.<sup>86</sup>
- ISE Holdings Certificate and ISE Holdings Bylaws require that, so long as ISE Holdings controls ISE Mercury, any changes to those documents be submitted to the ISE Mercury Board, and, if required, to be filed with, and as applicable approved by, the Commission pursuant to Section 19 of the Act and the rules thereunder before they may be effective.<sup>87</sup>

b. Upstream Owners

Although the Upstream Owners will not carry out any regulatory functions, the activities of each of the Upstream Owners with respect to the operation of ISE Mercury must be consistent with, and not interfere with, the self-regulatory obligations of ISE Mercury. The 2007 Resolutions, as supplemented by the supplemental Resolutions for ISE Mercury, the U.S. Exchange Holdings Certificate, and the U.S. Exchange Holdings Bylaws include certain provisions that are designed to maintain the independence of the self-regulatory function of ISE Mercury, enable ISE Mercury to operate in a manner that complies with the U.S. federal securities laws, including the objectives and requirements of Sections 6(b) and 19(g) of the Act,<sup>88</sup>

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<sup>86</sup> See ISE Holdings Bylaws, Article I, Section 1.6.

<sup>87</sup> See ISE Holdings Certificate, Article FOURTEENTH; and ISE Holdings Bylaws, Article X; see also supra notes 63-64 and accompanying text discussing a similar provision for ISE Mercury.

<sup>88</sup> 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

and facilitate the ability of ISE Mercury and the Commission to fulfill their regulatory and oversight obligations under the Act. Specifically:

- Each Upstream Owner and each board member, officer, and employee of the Upstream Owners will comply with the U.S. federal securities laws and the rules and regulations thereunder and cooperate with the Commission and ISE Mercury.<sup>89</sup>
- In discharging his or her responsibilities as a board member of an Upstream Owner, each such member must take into consideration the effect that the actions of the Upstream Owner will have on the ability of ISE Mercury to carry out its responsibilities under the Act.<sup>90</sup>
- The Upstream Owners, and their board members, officers, and employees, must give due regard to the preservation of the independence of the self-regulatory function of ISE Mercury.<sup>91</sup>
- The Upstream Owners, and their respective board members, officers, and employees agree to keep confidential information pertaining to the self-regulatory function of ISE Mercury, including, but not limited to, confidential information regarding

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<sup>89</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Sections (1), (7)(a) and (8)(a) and ISE Mercury Resolution Sections (2)(a), (2)(b) and (2)(c)); and U.S. Exchange Holdings Certificate, Articles TENTH and ELEVENTH. The Resolutions also provide that Eurex Frankfurt and Deutsche Börse will each take reasonable steps necessary to cause each person who subsequently becomes a board member of Eurex Frankfurt or Deutsche Börse to agree in writing to certain matters included in the Resolutions. See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Section (7) and ISE Mercury Resolution Section (2)(b)).

<sup>90</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Section (7)(f) and ISE Mercury Resolution Section (2)(b)); and U.S. Exchange Holdings Certificate, Article TENTH.

<sup>91</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Sections (5), (7)(d), and (8)(d) and ISE Mercury Resolution Section (2)); and U.S. Exchange Holdings Certificate, Article TWELFTH.

disciplinary matters, trading data, trading practices, and audit information, contained in the books and records of ISE Mercury and not use such information for any non-regulatory purposes.<sup>92</sup>

- The books and records of the Upstream Owners related to the activities of ISE Mercury must at all times be made available for, and the books and records of U.S. Exchange Holdings must be subject at all times to, inspection and copying by the Commission and ISE Mercury.<sup>93</sup>
- The books, records, officers, directors, and employees of each of the Upstream Owners will be deemed to be the books, records, officers, directors, and employees of ISE Mercury, to the extent that such books and records are related to, or such officers, directors (or equivalent in the case of Eurex Frankfurt and Deutsche Börse) and employees are involved in, the activities of ISE Mercury,<sup>94</sup> and the premises of U.S. Exchange Holdings will be deemed to be the premises of ISE Mercury.<sup>95</sup>

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<sup>92</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Sections (6), (7)(e) and (8)(e) and ISE Mercury Resolution Sections (1) and (2)); and U.S. Exchange Holdings Certificate, Article FOURTEENTH.

<sup>93</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Section (3) and ISE Mercury Resolution Section (2)(a)); and U.S. Exchange Holdings Certificate, Article FIFTEENTH. Additionally, the books and records of U.S. Exchange Holdings related to the activities of ISE Mercury will be maintained within the United States. See U.S. Exchange Holdings Certificate, Article FIFTEENTH.

<sup>94</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Sections (3) and (8)(c) and ISE Mercury Resolution Sections (2)(a) and (2)(c)); and U.S. Exchange Holdings Certificate, Article FIFTEENTH.

<sup>95</sup> See U.S. Exchange Holdings Certificate, Article FIFTEENTH.

- To the extent involved in the activities of ISE Mercury, the Upstream Owners, and their board members, officers, and employees, irrevocably submit to the jurisdiction of the U.S. federal courts and the Commission.<sup>96</sup>
- Any change to the governing documents that would have the effect of amending or repealing the ISE Mercury Resolutions or the 2007 Resolutions must be submitted to the ISE Mercury Board,<sup>97</sup> and, if required, filed with the Commission pursuant to Section 19 of the Act<sup>98</sup> and the rules thereunder before it may be effective.<sup>99</sup>

The ISE Trust Agreement, in addition to enforcing the ownership and voting limits,<sup>100</sup> also serves to effectuate compliance with the other commitments made under the ISE Mercury Resolutions, which incorporate the 2007 Resolutions. To accomplish that purpose, the ISE Trust would determine whether a Material Compliance Event<sup>101</sup> has occurred or is continuing. The

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<sup>96</sup> See, e.g., Form of German Parent Corporate Resolutions (2007 Resolution Sections (2), (7)(b), and (8)(b) and ISE Mercury Resolution Section (2)). See also U.S. Exchange Holdings Bylaws, Article VI, Section 16.

<sup>97</sup> See, e.g., Form of German Parent Corporate Resolutions (ISE Mercury Resolution Section (3)); U.S. Exchange Holdings Certificate, Article SIXTEENTH; and U.S. Exchange Holdings Bylaws, Article VI, Section 9.

<sup>98</sup> 15 U.S.C. 78s.

<sup>99</sup> See, e.g., Form of German Parent Corporate Resolutions (ISE Mercury Resolution Section (3)); U.S. Exchange Holdings Certificate, Article SIXTEENTH; and U.S. Exchange Holdings Bylaws, Article VI, Section 9. The requirement to submit changes to the ISE Mercury Board endures for as long as U.S. Exchange Holdings directly or indirectly controls ISE Mercury. See U.S. Exchange Holdings Bylaws, Article VI, Section 9.

<sup>100</sup> See supra notes 59-61 and 68-71 and accompanying text for a discussion of the ownership and voting limits.

<sup>101</sup> Under the ISE Trust Agreement, a “Material Compliance Event” is any state of facts, development, event, circumstance, condition, occurrence, or effect that results in the failure of any of the Affected Affiliates (as defined therein) to adhere to its respective commitments under the Resolutions in any material respect. See ISE Trust Agreement, Article I, Section 1.1.

ISE Trust would determine whether the occurrence and continuation of a Material Compliance Event requires the exercise of the Call Option.<sup>102</sup> The ISE Trust holds a Call Option over the capital stock of ISE Holdings that may be exercised if a Material Compliance Event has occurred and continues to be in effect. Upon exercise of the Call Option, the Trust Beneficiary<sup>103</sup> and ISE Holdings, as applicable, will take such actions as are necessary to transfer, or cause the transfer to the ISE Trust of a majority of the Voting Shares then outstanding.<sup>104</sup> The ISE Trust will transfer Deposited Shares from the ISE Trust back to the Trust Beneficiary, as provided in Section 4.2(h) of the ISE Trust Agreement, only if no Material Compliance Event is continuing or, notwithstanding its continuation, the Trustees determine that the retention of the Deposited Shares could not reasonably be expected to address the continuing Material Compliance Event, provided that the determination is filed with, or filed with and approved by, the Commission.<sup>105</sup>

The Commission believes that the provisions discussed above, which are designed to help maintain the independence of ISE Mercury's regulatory function and help facilitate the ability of ISE Mercury to carry out its regulatory responsibilities and operate in a manner consistent with the Act, are appropriate and consistent with the requirements of the Act, particularly with Section 6(b)(1), which requires, in part, an exchange to be so organized and have the capacity to carry out the purposes of the Act.<sup>106</sup> Whether ISE Mercury operates in compliance with the Act,

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<sup>102</sup> See supra note 68.

<sup>103</sup> Under the ISE Trust, the term "Trust Beneficiary" means U.S. Exchange Holdings.

<sup>104</sup> See ISE Trust Agreement, Article IV, Section 4.2. Specifically, if a Material Compliance Event occurs and continues to be in effect, the Trustees must take certain actions, including, after a specified cure period, the exercise of a Call Option for a transfer of the majority of capital stock of ISE Holdings that has the right by its terms to vote in the election of the ISE Holdings Board or on other matters.

<sup>105</sup> See ISE Trust Agreement, Article IV, Section 4.2.

<sup>106</sup> 15 U.S.C. 78f(b)(1).

however, depends on how it and ISE Holdings in practice implement the governance and other provisions that are the subject of this order. Accordingly, Section 19(h)(1) of the Act<sup>107</sup> provides the Commission with the authority “to suspend for a period not exceeding twelve months or revoke the registration of [an SRO], or to censure or impose limitations upon the activities, functions, and operations of [an SRO], if [the Commission] finds, on the record after notice and opportunity for hearing, that [the SRO] has violated or is unable to comply with any provision of [the Act], the rules or regulations thereunder, or its own rules or without reasonable justification or excuse has failed to enforce compliance” with any such provision by its members (including associated persons thereof).<sup>108</sup> If Commission were to find, or become aware of, through staff review and inspection or otherwise, facts indicating any violations of the Act, including without limitation Sections 6(b)(1)<sup>109</sup> and 19(g)(1),<sup>110</sup> these matters could provide the basis for a disciplinary proceeding under Section 19(h)(1) of the Act.<sup>111</sup>

Moreover, under Section 20(a) of the Act,<sup>112</sup> any person who, directly or indirectly, controls ISE Mercury would be jointly and severally liable with and to the same extent that ISE Mercury is liable under any provision of the Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Act<sup>113</sup> creates aiding and abetting liability for any person

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<sup>107</sup> See 15 U.S.C. 78s(h)(1).

<sup>108</sup> See id.

<sup>109</sup> See 15 U.S.C. 78f(b)(1).

<sup>110</sup> See 15 U.S.C. 78s(g)(1).

<sup>111</sup> See 15 U.S.C. 78s(h)(1).

<sup>112</sup> See 15 U.S.C. 78t(a).

<sup>113</sup> See 15 U.S.C. 78t(e).

who knowingly or recklessly provides substantial assistance to another person in violation of any provision of the Act or rule thereunder. Further, Section 21C of the Act authorizes the Commission to enter a cease-and-desist order against any person who has been “a cause of” a violation of any provision of the Act through an act or omission that the person knew or should have known would contribute to the violation.<sup>114</sup> These provisions are applicable to all entities controlling ISE Mercury, including the ISE Trust, ISE Holdings, and the Upstream Owners.

### 3. Regulation of ISE Mercury

As a prerequisite to the Commission’s granting of an exchange’s application for registration, an exchange must be so organized and have the capacity to carry out the purposes of the Act.<sup>115</sup> Specifically, an exchange must be able to enforce compliance by its members, and persons associated with its members, with the Act and the rules and regulations thereunder and the rules of the exchange.<sup>116</sup> The discussion below summarizes how ISE Mercury proposes to structure and conduct its regulatory operations.

#### a. Corporate Governance Committee and Finance and Audit Committee

ISE Mercury will have a Chief Regulatory Officer (“CRO”) with general responsibility for supervision of the regulatory operations of ISE Mercury.<sup>117</sup> The CRO will report to the Corporate Governance Committee<sup>118</sup> and to the President/Chief Executive Officer, although the ISE Mercury Board would retain the power to call the CRO to report directly to the Board as

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<sup>114</sup> See 15 U.S.C. 78u-3(a).

<sup>115</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>116</sup> See id. See also Section 19(g) of the Act, 15 U.S.C. 78s(g).

<sup>117</sup> See Exhibit L to the Form 1 Application.

<sup>118</sup> The Corporate Governance Committee will consist of at least three directors, all of whom must be Non-Industry Directors. See ISE Mercury Constitution, Article V, Section 5.4.

needed. The CRO also may call special meetings of the Board, as necessary.<sup>119</sup> The Corporate Governance Committee will meet regularly with the CRO to review regulatory matters.<sup>120</sup>

The Corporate Governance Committee will monitor the regulatory program for sufficiency, effectiveness, and independence, and will oversee trade practices and market surveillance, audits, examinations, and other regulatory responsibilities with respect to members and the conduct of investigations.<sup>121</sup> The Corporate Governance Committee also will supervise the CRO; will receive an annual report from the CRO assessing ISE Mercury's self-regulatory program for the Board; will recommend changes that would ensure fair and effective regulation; and will review regulatory proposals and advise the Board as to whether and how such changes may impact regulation.<sup>122</sup> The Corporate Governance Committee will review annually the regulatory budget and specifically inquire into the adequacy of the resources available in the budget for regulatory activities.<sup>123</sup> The Corporate Governance Committee will authorize unbudgeted expenditures for necessary regulatory expenses.<sup>124</sup> In addition, the Finance and Audit Committee will provide oversight over the systems of internal controls established by management and the Board and the Exchange's regulatory and compliance process.<sup>125</sup>

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<sup>119</sup> See Exhibit L to the Form 1 Application.

<sup>120</sup> See id.

<sup>121</sup> See id.

<sup>122</sup> See id.

<sup>123</sup> See id.

<sup>124</sup> See id.

<sup>125</sup> See id.

The Compensation Committee will set compensation for the CRO.<sup>126</sup> The Corporate Governance Committee, in its sole discretion, will make hiring and termination decisions with respect to the CRO, in each case taking into consideration any recommendations made by the President.<sup>127</sup> The Corporate Governance Committee will be informed about the compensation of the CRO, including factors affecting changes thereto.<sup>128</sup>

b. Regulatory Funding

To help ensure the Commission that it has and will continue to have adequate funding to be able to meet its responsibilities under the Act, ISE Mercury represents in its Form 1 Application that, prior to commencing operations as a national securities exchange, ISE Holdings will provide sufficient funding to ISE Mercury for the exchange to carry out its responsibilities under the Act.<sup>129</sup> Specifically, ISE Mercury represents that ISE Holdings has made a cash contribution to ISE Mercury of \$5 million, in addition to previously provided “in-kind” contributions of legal, regulatory and infrastructure-related services to ISE Mercury.<sup>130</sup> ISE

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<sup>126</sup> See id.

<sup>127</sup> See id.

<sup>128</sup> See id.

<sup>129</sup> See Exhibit I to the Form 1 Application.

<sup>130</sup> Other applicants for registration as a national securities exchange have noted in their Form 1 applications similar funding commitments and representations. In ISE Gemini, ISE Holdings represented that it would make a capital contribution of \$5 million to ISE Gemini. See ISE Gemini Order, supra note 27. BOX represented that, prior to launch, BOX Group LLC would allocate sufficient operational assets, including regulatory infrastructure and industry and regulatory memberships, along with a \$1,000,000 loan to BOX. See BOX Order, supra note 37. In MIAX, the exchange represented that Miami International Holdings, Inc. would allocate sufficient operational assets and make a capital contribution of not less than \$2,000,000 into MIAX capital account prior to launching operations. See MIAX Order, supra note 28.

Mercury represents that the cash and in-kind contributions to ISE Mercury will be adequate to operate ISE Mercury, including its regulatory program.<sup>131</sup>

ISE Mercury also represents in its Form 1 Application that there is a written agreement between ISE Mercury and ISE Holdings that requires ISE Holdings to provide adequate funding for ISE Mercury's operation, including the regulation of ISE Mercury.<sup>132</sup> This agreement further provides that ISE Holdings will reimburse ISE Mercury for its costs and expenses to the extent ISE Mercury's assets are insufficient to meet its costs and expenses.<sup>133</sup> Excess funds, as solely determined by ISE Mercury, will be remitted to ISE Holdings.<sup>134</sup> Further, ISE Mercury will receive all fees, including regulatory fees and trading fees, payable by ISE Mercury's members, as well as any funds received from any applicable market data fees and OPRA tape revenue.<sup>135</sup> Regulatory Funds will not be used for non-regulatory purposes and will be used to fund the legal, regulatory and surveillance operations of ISE Mercury.<sup>136</sup>

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<sup>131</sup> See Exhibit I to the Form 1 Application.

<sup>132</sup> See Exhibit I to the Form 1 Application. ISE Gemini, BOX and MIAX also represented in their Form 1 applications that there would be explicit agreements with their respective holding companies to provide adequate funding for the exchanges' operations, including regulation.

<sup>133</sup> See id.

<sup>134</sup> See id.

<sup>135</sup> See id.

<sup>136</sup> See ISE Mercury LLC Agreement, Article III, Section 3.3. The ISE Mercury LLC Agreement defines "Regulatory Funds" as fees, fines or penalties derived from the regulatory operations of ISE Mercury, provided that Regulatory Funds shall not include revenues derived from listing fees, market data revenues, transaction revenues or any other aspect of the commercial operations of ISE Mercury or a facility of ISE Mercury, even if a portion of such revenues are used to pay costs associated with the regulatory operations of ISE Mercury. Id. This definition is consistent with the rules of other SROs. See, e.g., MIAX Second Amended and Restated LLC Agreement, Section 16; and MIAX Amended and Restated By-Laws, Article IX, Section 9.4.

c. Rule 17d-2 Agreements; Regulatory Contracts with FINRA and ISE

Unless the SRO is relieved of this responsibility pursuant to Section 17(d) or Section 19(g)(2) of the Act, Section 19(g)(1) of the Act,<sup>137</sup> among other things, requires every SRO registered as a national securities exchange, absent reasonable justification or excuse, to enforce compliance by its members and persons associated with its members with the Act, the rules and regulations thereunder, and the SRO's own rules.<sup>138</sup> Rule 17d-2 of the Act<sup>139</sup> permits SROs to propose joint plans to allocate regulatory responsibilities among themselves for their common rules with respect to their common members.<sup>140</sup> These agreements, which must be filed with and declared effective by the Commission, generally cover areas where each SRO's rules substantively overlap, including such regulatory functions as personnel registration and sales practices. Without this relief, the statutory obligation of each individual SRO could result in a pattern of multiple examinations of broker-dealers that maintain memberships in more than one SRO. Such regulatory duplication would add unnecessary expenses for common members and

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<sup>137</sup> 15 U.S.C. 78s(g)(1).

<sup>138</sup> 15 U.S.C. 78q(d) and 15 U.S.C. 78s(g)(2), respectively.

<sup>139</sup> See Section 17(d)(1) of the Act and Rule 17d-2 thereunder, 15 U.S.C. 78q(d)(1) and 17 CFR 240.17d-2. Section 17(d)(1) of the Act allows the Commission to relieve an SRO of certain responsibilities with respect to members of the SRO who are also members of another SRO. Specifically, Section 17(d)(1) allows the Commission to relieve an SRO of its responsibilities to: (i) receive regulatory reports from such members; (ii) examine such members for compliance with the Act and the rules and regulations thereunder, and the rules of the SRO; or (iii) carry out other specified regulatory responsibilities with respect to such members.

<sup>140</sup> 17 CFR 240.17d-2. Section 19(g)(1) of the Act requires every SRO to examine its members and persons associated with its members and to enforce compliance with the federal securities laws and the SRO's own rules, unless the SRO is relieved of this responsibility pursuant to Section 17(d) of the Act. Section 17(d) was intended, in part, to eliminate unnecessary multiple examinations and regulatory duplication with respect to Common Members. See Securities Exchange Act Release No. 12935 (October 28, 1976), 41 FR 49091 (November 8, 1976).

their SROs. A 17d-2 plan that is declared effective by the Commission relieves the specified SRO of those regulatory responsibilities allocated by the plan to another SRO.<sup>141</sup> Many SROs have entered into Rule 17d-2 agreements.<sup>142</sup>

ISE Mercury represents to the Commission that it will enter into the following allocation of regulatory responsibilities pursuant to Rule 17d-2 of the Act (“17d-2 Plans”),<sup>143</sup> including the two existing multiparty plans applicable to options trading:

- Multiparty 17d-2 Plan for the Allocation of Regulatory Responsibility for Options Sales Practice Matters;<sup>144</sup>
- Multiparty 17d-2 Plan for the Allocation of Regulatory Responsibility for Options Related Market Surveillance Matters;<sup>145</sup> and

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<sup>141</sup> See id.

<sup>142</sup> See, e.g., Securities Exchange Act Release Nos. 73641 (November 19, 2014), 79 FR 70230 (November 25, 2014) (File No. 4-678) (Financial Industry Regulatory Authority, Inc. (“FINRA”)/MIAX); 70053 (July 26, 2013), 78 FR 46656 (August 1, 2013) (File No. 4-663) (FINRA/ISE Gemini) (“ISE Gemini Bilateral 17d-2 Plan”); 59218 (January 8, 2009), 74 FR 2143 (January 14, 2009) (File No. 4-575) (FINRA/Boston Stock Exchange, Inc.); 58818 (October 20, 2008), 73 FR 63752 (October 27, 2008) (File No. 4-569) (FINRA/BATS Exchange, Inc.); 55755 (May 14, 2007), 72 FR 28087 (May 18, 2007) (File No. 4-536) (National Association of Securities Dealers, Inc. (“NASD”) (n/k/a FINRA) and Chicago Board of Options Exchange, Inc. (“CBOE”) concerning the CBOE Stock Exchange, LLC); 55367 (February 27, 2007), 72 FR 9983 (March 6, 2007) (File No. 4-529) (NASD/ISE); and 54136 (July 12, 2006), 71 FR 40759 (July 18, 2006) (File No. 4-517) (NASD/The Nasdaq Stock Market LLC).

<sup>143</sup> Rule 17d-2 under the Act permits SROs to propose joint plans for the allocation of regulatory responsibilities with respect to their common members (i.e., 17d-2 plans).

<sup>144</sup> See Exhibit L to the Form 1 Application. See also Securities Exchange Act Release No. 68363 (December 5, 2012), 77 FR 73711 (December 11, 2012) (File No. S7-966) (notice of filing and order approving and declaring effective an amendment to the multiparty 17d-2 plan concerning options-related sales practice matters).

<sup>145</sup> See Exhibit L to the Form 1 Application. See also Securities Exchange Act Release No. 68362 (December 5, 2012), 77 FR 73719 (December 11, 2012) (File No. 4-551) (notice

- Bilateral 17d-2 Plan with FINRA that would cover, among other things, general inspection, examination, and enforcement activity.<sup>146</sup>

If the Commission declares effective the amendments to the multilateral 17d-2 Plans and the new bilateral 17d-2 Plan, another SRO (often FINRA) would assume certain regulatory responsibility for members of ISE Mercury that are also members of the SRO that assumes the regulatory responsibilities. This regulatory structure would be consistent with that of other exchanges, including ISE.<sup>147</sup>

In addition, ISE Mercury represents that it will enter into a third-party Regulatory Service Agreement (“RSA”) with FINRA.<sup>148</sup> Under the RSA, FINRA<sup>149</sup> will carry out certain specified regulatory activities on behalf of ISE Mercury. For example, FINRA, in its capacity as service provider to ISE Mercury, will provide member operation services, including membership application review, conducting market surveillance investigation services, conducting routine and cause examination services, assisting ISE Mercury with disciplinary proceedings pursuant to ISE Mercury’s rules including conducting hearings, and providing dispute resolution services to

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of filing and order approving and declaring effective an amendment to the multiparty 17d-2 plan concerning options-related market surveillance).

<sup>146</sup> See Exhibit L of Amendment No. 2 to the Form 1 Application. See also ISE Gemini Bilateral 17d-2 Plan, supra note 142.

<sup>147</sup> Amendments to the multilateral 17d-2 Plans and the new bilateral 17d-2 Plan are not before the Commission as part of this order and, therefore, the Commission is not acting on them at this time.

<sup>148</sup> See, e.g., Exhibit L to the Form 1 Application.

<sup>149</sup> FINRA executed a single RSA with both ISE and ISE Mercury as signatories. The single RSA, however, has two separate statements of work. The first statement of work describes the specified regulatory activities that FINRA will carry out on behalf of ISE. The second statement of work describes the specified regulatory activities that FINRA will carry out on behalf of ISE Mercury.

ISE Mercury members on behalf of ISE Mercury.<sup>150</sup> ISE Mercury, as an SRO, however, has the ultimate legal responsibility for the regulation of its members and market. This regulatory structure would be consistent with that of other exchanges.<sup>151</sup>

ISE Mercury also represents that it will enter into a facilities management agreement (“FMA”) with ISE.<sup>152</sup> Pursuant to the proposed FMA, ISE intends to provide to ISE Mercury certain services, including, for example, business management services, facilities management services, IT services, fiscal services, as well as other regulatory compliance services and other legal services, such as surveillance programs, legal programs, systems and other operational services.<sup>153</sup> ISE Mercury, however, will retain ultimate legal responsibility for the regulation of its members and market.

The Commission believes that it is consistent with the Act for ISE Mercury to contract with other SROs to perform certain examination, enforcement, and disciplinary functions.<sup>154</sup> These functions are fundamental elements of a regulatory program, and constitute core self-regulatory functions. The Commission believes that both FINRA, as an SRO that provides contractual services to other SROs, and ISE, as an SRO that currently operates an options

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<sup>150</sup> See Exhibit L to the Form 1 Application.

<sup>151</sup> For example, ISE Gemini, ISE, EDGA Exchange, Inc., EDGX Exchange Inc., and BATS have entered into 17d-2 Plans and RSAs with FINRA.

<sup>152</sup> See, e.g., Exhibit L to the Form 1 Application. The FMA with ISE provides, in part, for the provision of legal and other regulatory compliance services.

<sup>153</sup> See id.

<sup>154</sup> See, e.g., Regulation ATS Release, supra note 28. See also Securities Exchange Act Release Nos. 50122 (July 29, 2004), 69 FR 47962 (August 6, 2004) (SR-Amex-2004-32) (order approving rule that allowed Amex to contract with another SRO for regulatory services) (“American Stock Exchange (“Amex”) Regulatory Services Approval Order”); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080) (“NOM Approval Order”); Nasdaq Order, supra note 27; and BATS Order, supra note 27.

exchange, should have the capacity to perform these functions for ISE Mercury.<sup>155</sup> However, ISE Mercury, unless relieved by the Commission of its responsibility,<sup>156</sup> bears the ultimate responsibility for self-regulatory responsibilities and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on ISE Mercury's behalf. In performing these regulatory functions, however, the SRO retained to perform specified regulatory functions may nonetheless bear liability for causing or aiding and abetting the failure of ISE Mercury to perform its regulatory functions.<sup>157</sup> Accordingly, although FINRA and ISE will not act on their own behalves under their respective SRO responsibilities in carrying out the above mentioned regulatory services for ISE Mercury, as the SROs retained to perform regulatory functions, FINRA and ISE may have secondary liability if, for example, the Commission finds that the contracted functions are being performed so inadequately as to cause a violation of the federal securities laws by ISE Mercury.

As part of its FMA with ISE, ISE Mercury proposes to use dual employees to staff its regulatory services program. In other words, current ISE employees will also serve in a similar capacity for ISE Mercury under the FMA. ISE Mercury represents that the FMA will contain an

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<sup>155</sup> See, e.g., Amex Regulatory Services Approval Order, supra note 154; NOM Approval Order, supra note 154; and Nasdaq Order, supra note 27. The Commission notes that the RSA and FMA are not before the Commission and, therefore, the Commission is not acting on them.

<sup>156</sup> See supra note 139.

<sup>157</sup> For example, if failings by the SRO retained to perform regulatory functions have the effect of leaving an exchange in violation of any aspect of the exchange's self-regulatory obligations, the exchange will bear direct liability for the violation, while the SRO retained to perform regulatory functions may bear liability for causing or aiding and abetting the violation. See, e.g., ISE Gemini Order, supra note 27; MIAX Order, supra note 28; BOX Order, supra note 37; and Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (File No. 10-127) (order granting the exchange registration of ISE) ("ISE Order").

obligation on the part of ISE Mercury and ISE to preserve the other party's information and materials which are confidential, proprietary, and/or trade secrets and prevent unauthorized use or disclosure to third parties.<sup>158</sup>

The Commission believes that the use of ISE employees by ISE Mercury is appropriate, as the operations, rules, and management of ISE and ISE Mercury will overlap to a considerable degree such that ISE Mercury should benefit by leveraging the experience of current ISE staff. The Commission has approved such arrangements in a similar context.<sup>159</sup> However, the Commission expects ISE and ISE Mercury to monitor the workload of their shared employees and supplement their staffs, if necessary, so that ISE Mercury maintains sufficient personnel to allow it to carry out the purposes of the Act and enforce compliance with the rules of ISE Mercury and the federal securities laws.

D. Trading System

1. Access to ISE Mercury

Access to ISE Mercury will be through the use of Exchange Rights.<sup>160</sup> Through an application process, organizations will be approved to become members of ISE Mercury and to exercise trading rights.<sup>161</sup> Exchange Rights will not convey any ownership rights, but will

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<sup>158</sup> See Exhibit L to the Form 1 Application.

<sup>159</sup> See, e.g., ISE Gemini Order, supra note 27; Securities Exchange Act Release No. 61152 (December 10, 2009), 74 FR 66699 (December 16, 2009) (File No. 10-191) (order granting registration to C2 Options Exchange) (“C2 Order”).

<sup>160</sup> See supra note 19.

<sup>161</sup> The term “Member” means an organization that has been approved to exercise trading rights associated with Exchange Rights, and the term “Membership” refers to the trading privileges associated with Exchange Rights. See ISE Mercury Rules 100(a)(23) and 100(a)(24). Under ISE Mercury Rules 300 and 302(c), ISE Mercury shall issue memberships that confer the ability to transact on ISE Mercury, although no rights shall be conferred upon a member except those set forth in the ISE Mercury LLC Agreement

provide for voting rights for representation on the ISE Mercury Board and will confer the ability to transact on ISE Mercury.<sup>162</sup> Exchange Rights may not be leased and are not transferable except in the event of a change in control of a member or corporate reorganization involving a member.<sup>163</sup> There is no limit on the number of Exchange Rights issued by ISE Mercury.<sup>164</sup>

Membership in ISE Mercury will be open to any broker-dealer registered under Section 15(b) of the Act that meets the standards for membership set forth in the rules of ISE Mercury.<sup>165</sup> The Exchange's denials from, and impositions of conditions upon, becoming or continuing to be a member may be appealed pursuant to rules governing hearing and review, described in Section II.E below.<sup>166</sup> In addition to its regular membership application process, ISE Mercury also will provide a process whereby a current member of ISE or ISE Gemini in good standing that is a registered broker-dealer can submit an abbreviated "waive-in" application to ISE Mercury.<sup>167</sup> This waive-in process is similar to arrangements in place at other exchanges.<sup>168</sup>

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or ISE Mercury Rules as amended from time to time. A membership shall not convey any ownership interest in the Exchange. See ISE Mercury Rules 300 and 302(c).

<sup>162</sup> See ISE Mercury Rules 300 and 302(c); see also ISE Mercury LLC Agreement, Article VI, Sections 6.1 and 6.3.

<sup>163</sup> See ISE Mercury Rule 302(c). In such case, member status may be transferred to a qualified affiliate or successor upon written notice to ISE Mercury. Id.

<sup>164</sup> See ISE Mercury Rule 300; see also ISE Mercury LLC Agreement, Article VI, Section 6.1.

<sup>165</sup> See ISE Mercury Rule 301.

<sup>166</sup> See ISE Mercury Rule 1700 Series, which incorporates by reference ISE Rule 1700 Series.

<sup>167</sup> See ISE Mercury Rule 302(a).

<sup>168</sup> See, e.g., C2 Options Exchange, Inc. Rule 3.1(c)(1) (containing a similar expedited waive-in membership process for members of CBOE).

ISE Mercury will have three classes of membership: (1) PMMs; (2) CMMs; and (3) EAMs.<sup>169</sup> PMM and CMMs may seek appointment to become market makers in one or more options classes traded on the Exchange.<sup>170</sup> ISE Mercury proposes to allow firms that register as market makers to receive special privileges or rights over non-market maker members, such as participation entitlements for PMMs, if they satisfy certain affirmative and negative market making obligations on the Exchange.<sup>171</sup> This is similar to arrangements in place at other exchanges, such as ISE and ISE Gemini.<sup>172</sup>

The Commission finds that ISE Mercury's proposed membership rules are consistent with the Act, including Section 6(b)(2) of the Act,<sup>173</sup> which requires the rules of an exchange to provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member of such exchange and any person may become associated with a member thereof. ISE Mercury's proposed rules with respect to exchange membership are substantively similar to the rules of other exchanges.<sup>174</sup>

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<sup>169</sup> See ISE Mercury Rule 301(c).

<sup>170</sup> See ISE Mercury Rule 800 Series.

<sup>171</sup> See ISE Mercury Rules 713, 802 and 803. See *infra* Section 0. for further discussion of market maker privileges and obligations.

<sup>172</sup> See, e.g., ISE Rules 713, 802 and 803, and ISE Gemini Rules 713, 802 and 803 (containing similar rights and obligations for market makers on ISE and ISE Gemini, respectively). ISE Mercury's approach is consistent with the rules of other exchanges that have no limit on the number of exchange rights, or their functional equivalent, that may be issued by the exchange. See, e.g., C2 Order, *supra* note 159.

<sup>173</sup> 15 U.S.C. 78f(b)(2).

<sup>174</sup> See, e.g., ISE Gemini Rule 300 Series ("Membership"); MIAX Rule 200 Series ("Access").

The Commission notes that pursuant to Section 6(c) of the Act,<sup>175</sup> an exchange must deny membership to any person, other than a natural person, that is not a registered broker or dealer, any natural person that is not, or is not associated with, a registered broker or dealer, and registered broker-dealers that do not satisfy certain standards, such as financial responsibility or operational capacity. As a registered exchange, ISE Mercury must independently determine if an applicant satisfies the standards set forth in the Act, regardless of whether an applicant is a member of another SRO.<sup>176</sup>

In addition, ISE Mercury also will allow non-members to access ISE Mercury as “sponsored customers” of an ISE Mercury member, subject to certain rules.<sup>177</sup> The sponsoring member will be responsible for implementing policies and procedures to supervise and monitor the trading of its sponsored users to ensure compliance with all applicable federal securities laws and rules and ISE Mercury rules.<sup>178</sup> ISE Mercury’s proposed sponsored access rules are similar to the rules of other exchanges that provide for sponsored access<sup>179</sup> and are consistent with Rule 15c3-5 under the Act.<sup>180</sup>

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<sup>175</sup> 15 U.S.C. 78f(c).

<sup>176</sup> See, e.g., ISE Gemini Order, supra note 27, at 78 FR 46633; MIAX Order, supra note 28, at 77 FR 73074; BOX Order, supra note 37, at 77 FR 26337; BATS Order, supra note 27, at 73 FR 49502; and Nasdaq Order, supra note 27, at 71 FR 3555.

<sup>177</sup> See ISE Mercury Rule 706, Supplementary Material .01.

<sup>178</sup> See ISE Mercury Rule 706. See also 17 CFR 240.15c3-5.

<sup>179</sup> See, e.g., ISE Rule 706; see also ISE Gemini Rule 706; MIAX Rule 210.

<sup>180</sup> 17 CFR 240.15c3-5.

## 2. Linkage

ISE Mercury intends to become a participant in the Plan Relating to Options Order Protection and Locked/Crossed Markets or any successor plan (“Linkage Plan”).<sup>181</sup> If admitted as a participant to the Linkage Plan, other plan participants will be able to send orders to ISE Mercury in accordance with the terms of the plan as applied to ISE Mercury.

ISE Mercury rules include relevant definitions; establish the conditions pursuant to which members may enter orders in accordance with the Linkage Plan; impose obligations on ISE Mercury regarding how it must process incoming orders; establish a general standard that members and ISE Mercury should avoid trade-throughs; establish potential regulatory liability for members that engage in a pattern or practice of trading through other exchanges; and establish obligations with respect to locked and crossed markets.

The Commission believes that ISE Mercury has proposed rules that are designed to comply with the requirements of the Linkage Plan.<sup>182</sup> Further, as provided below, before ISE Mercury can commence operations as an exchange, it must become a participant in the Linkage Plan.

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<sup>181</sup> See Exhibit E to the Form 1 Application, Section B for a discussion of the Linkage Plan; and Exhibit L to the Form 1 Application. See also Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (File No. 4-546) (order approving the National Market System Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.).

<sup>182</sup> See, e.g., ISE Mercury Rules relating to Intermarket Linkage in Rule 1900 Series, which incorporates by reference ISE Rule 1900 Series.

### 3. Market Makers

#### a. Registration of Market Makers

Members of ISE Mercury may apply to become one of two types of market maker: PMMs or CMMs (collectively, “Market Makers”). Market Makers are entitled to receive certain benefits and privileges in exchange for fulfilling certain affirmative and negative market-making obligations.<sup>183</sup> Each class of Market Maker will receive a specific level of benefits and privileges in exchange for a specific level of obligation from such Market Maker.

To begin the process of registering as a PMM or CMM, a member will be required to file a written application with ISE Mercury.<sup>184</sup> In reviewing a member’s application for membership, ISE Mercury will consider, among other things, the applicant’s market making ability.<sup>185</sup> To qualify for registration as a Market Maker, a member of ISE Mercury must meet the requirements established in Rule 15c3-1 under the Act<sup>186</sup> and the general requirements set forth in ISE Mercury Rule 800 series, including the minimum financial requirements of ISE Mercury Rule 809.<sup>187</sup> All members who are approved to become Market Makers will be

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<sup>183</sup> Market Makers’ benefits and obligations are discussed in greater detail in the following section.

<sup>184</sup> See ISE Mercury Rule 800(b).

<sup>185</sup> See id. The provision permitting ISE Mercury to consider “such other factors as [it] deems appropriate” must be applied in a manner that is consistent with the Act, including provisions that prohibit an exchange from acting in an unfairly discriminatory manner. See 15 U.S.C. 78f(b)(5); see also ISE Gemini Order, supra note 27, at 78 FR 46634 n. 195; MIAX Order, supra note 28, at 77 FR 73074 n.149.

<sup>186</sup> 17 CFR 240.15c3-1.

<sup>187</sup> See ISE Mercury Rule 800 Series. See also ISE Mercury Rule 1300 Series relating to Net Capital Requirements, which incorporates by reference ISE Rule 1300 Series.

designated as specialists on ISE Mercury for all purposes under the Act and rules thereunder.<sup>188</sup>

ISE Mercury will not limit the number of qualifying entities that may become Market Makers.<sup>189</sup>

In addition, all ISE and ISE Gemini market makers in good standing will be eligible for an Exchange Right in the same membership category in which they operate on ISE and ISE Gemini, respectively, to trade on ISE Mercury.<sup>190</sup> For example, a CMM in good standing on ISE will be eligible to become a CMM on ISE Mercury, through the submission and approval of an ISE Mercury Waive-In Membership Application.<sup>191</sup>

Once approved, a Market Maker may seek appointment to make markets in one or more options classes traded on the ISE Mercury.<sup>192</sup> Further, ISE Mercury will provide non-ISE and ISE Gemini members with at least sixty days advance written notice of the date upon which the Exchange will allocate options classes and appoint market makers in order to ensure that non-ISE and ISE Gemini members have a reasonable opportunity to participate in those processes.<sup>193</sup> A market participant must have completed a membership application to be eligible to participate in the appointment and allocation processes.<sup>194</sup>

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<sup>188</sup> See ISE Mercury Rule 800(a).

<sup>189</sup> See ISE Mercury Rule 300. See also Exhibit E to the Form 1 Application, Section 1.

<sup>190</sup> See ISE Mercury Rule 302(a).

<sup>191</sup> See id. See also Exhibit F to the Form 1 Application.

<sup>192</sup> See ISE Mercury Rule 802(a).

<sup>193</sup> A non-ISE and ISE-Gemini member must have a completed a membership application to be eligible to participate in the processes. See ISE Mercury Rule 302(b).

<sup>194</sup> See Exhibit E to the Form 1 Application, Section A (“Introduction”).

Either the ISE Mercury Board or a committee thereof<sup>195</sup> will appoint classes of options contracts traded on ISE Mercury to Market Makers, taking into consideration: (1) the financial resources available to the Market Maker; (2) the Market Maker's experience and expertise in market making or options trading; and (3) the maintenance and enhancement of competition among Market Makers in each option class to which they are appointed.<sup>196</sup> No appointment of a Market Maker will be without the Market Maker's consent to such appointment, provided that refusal to accept an appointment may be deemed sufficient cause for termination or suspension of a market maker's registration.<sup>197</sup> ISE Mercury will appoint a PMM to each options class traded on ISE Mercury.<sup>198</sup> Once appointed, ISE Mercury will surveil a Market Maker's activity for continued compliance with all applicable rules and requirements, which are discussed in more detail below.<sup>199</sup>

The Commission finds that ISE Mercury's proposed rules for the registration and appointment of Market Makers are consistent with the Act. In particular, ISE Mercury's rules provide an objective process by which a member could become a Market Maker on ISE Mercury and provide for oversight by ISE Mercury to monitor for continued compliance by Market Makers with the terms of their application for such status. The Commission notes that ISE Mercury's proposed Market Maker registration and appointment requirements are similar to

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<sup>195</sup> See ISE Mercury Rule 802(a). ISE Mercury Rule 1700 Series provides the process for hearings, review, and arbitration of claims by persons economically aggrieved by ISE Mercury action, which would include denial of registration as a Market Maker.

<sup>196</sup> See id.

<sup>197</sup> See id.

<sup>198</sup> See ISE Mercury Rule 802(b).

<sup>199</sup> See ISE Mercury Rule 802(e).

those of other options exchanges.<sup>200</sup>

b. Market Maker Obligations

Pursuant to ISE Mercury rules, Market Makers will be subject to a number of general obligations. In particular, the transactions of a Market Maker should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market and a Market Maker should not make bids or offers or enter into transactions that are inconsistent with such a course of dealings.<sup>201</sup> A Market Maker has a continuous obligation to engage, to a reasonable degree under the existing circumstances, in dealings for his own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a temporary disparity between the supply of and demand for a particular options contract, or a temporary distortion of the price relationships between options contracts of the same class.<sup>202</sup> For all series of option classes which the Market Maker is appointed, the Market Maker is expected to: (1) compete with other Market Makers to improve the market; (2) make markets that, absent changed market conditions, will be honored for the number of contracts entered into the ISE Mercury's system; (3) update market quotations in response to changed market conditions; (4) price options contracts fairly by, among other things, bidding and offering so as to create the prescribed bid/ask differentials.<sup>203</sup> These provisions are similar to arrangements in place at other

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<sup>200</sup> See, e.g., ISE Rules 800 and 801, ISE Gemini Rules 800 and 801, and MIAX Rule 600 (registration); ISE Rule 802, ISE Gemini Rule 802, and MIAX Rule 602 (appointment).

<sup>201</sup> See ISE Mercury Rule 803(a).

<sup>202</sup> See ISE Mercury Rule 803(b).

<sup>203</sup> See ISE Mercury Rule 803(b)(1)-(4). Specifically, under ISE Mercury Rule 803(b)(4), following the opening rotation, Market Makers must create differences of no more than \$5 between the bid and offer. Prior to the opening rotation, spread differentials shall be no more than \$.25 between the bid and offer for each options contract for which the bid is less than \$2, no more than \$.40 where the bid is at least \$2 but does not exceed \$5, no

options exchanges.<sup>204</sup>

Further, Market Makers must maintain minimum net capital in accordance with ISE Mercury rules, including the minimum financial requirement pursuant to ISE Mercury Rule 809, in addition to the Act and rules and regulations thereunder.<sup>205</sup>

ISE Mercury's rules governing Market Maker quoting obligations also are tailored to the specific class of Market Maker (i.e., PMM or CMM).<sup>206</sup> Specifically, a PMM will be subject to the highest standard applicable on ISE Mercury. On a daily basis, PMMs must enter continuous two-sided quotations and enter into any resulting transactions in all of the series listed on the ISE Mercury of the options classes to which they are appointed.<sup>207</sup> PMMs are also required to participate in the opening rotation.<sup>208</sup> Although a CMM is not required to enter quotations in the options classes to which it is appointed, whenever a CMM does enter a quote in an options class to which it is appointed, the CMM must then provide continuous quotations in that class for 60%

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more than \$.50 where the bid is more than \$5 but does not exceed \$10, no more than \$.80 where the bid is more than \$10 but does not exceed \$20, and no more than \$1 where the bid is \$20 or greater, provided that the ISE Mercury may establish differences other than the above for one or more options series. These differentials do not apply to in-the-money options series where the underlying securities market is wider than the differentials.

<sup>204</sup> See, e.g., ISE Gemini Rules 802 and 803 (containing similar rights and obligations for market makers on ISE Gemini).

<sup>205</sup> See ISE Mercury Rule 1300 Series, which incorporates by reference ISE Rule 1300 Series; see also ISE Mercury Rule 809.

<sup>206</sup> See ISE Mercury Rule 804.

<sup>207</sup> See ISE Mercury Rule 804(e)(1); see also ISE Mercury Rule 804(c). A PMM shall be deemed to have provided continuous quotes pursuant to paragraph (e)(1) of Rule 804 if it provides two-sided quotes for 90% of the time that an options class is open for trading on the ISE Mercury. See ISE Mercury Rule 804, Supplementary Material .01.

<sup>208</sup> See ISE Mercury Rule 701(b)(1).

of the time the options class is open for trading on ISE Mercury.<sup>209</sup> Further, whenever in the judgment of an ISE Mercury official it is necessary in the interest of fair and orderly markets to do so, CMMs may be called upon to submit a single quote or maintain continuous quotes in one or more series of options class to which the CMM is appointed.<sup>210</sup> For purposes of meeting the continuous quoting obligations discussed herein, a Market Maker's quote must meet the bid/ask differential requirements of ISE Mercury Rule 803(b)(4).<sup>211</sup>

In options classes other than to which it is appointed, ISE Mercury's rules provide that a Market Maker should not engage in transactions in an account in which it has an interest that are disproportionate in relation to, or in derogation of, the performance of its market making obligations.<sup>212</sup> Further, the total number of contracts executed during a quarter by a CMM in options classes to which it is not appointed may not exceed 25% of the total number of contracts traded by such CMMs in classes to which it is appointed and with respect to which it was quoting pursuant to ISE Mercury Rule 804(e)(2).<sup>213</sup> Similarly, the total number of contracts executed during a quarter by a PMM in options classes to which it is not appointed may not exceed 10% of the total number of contracts traded per each PMM membership.<sup>214</sup>

If ISE Mercury finds any failure by a Market Maker to properly perform as a market

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<sup>209</sup> See ISE Mercury Rule 804(e)(2). A CMM must maintain continuous quotations for at least 90% of the time the options class for which it receives Preferred Orders is open for trading on the ISE Mercury. See ISE Mercury Rule 804(e)(2)(iii); see also ISE Mercury Rule 713, Supplementary Material .03 regarding Preferred Orders.

<sup>210</sup> See ISE Mercury Rule 804(e)(2)(iv).

<sup>211</sup> See ISE Mercury Rule 804(e)(1)-(2). See also supra note 203.

<sup>212</sup> See ISE Mercury Rule 803(d). Among other things, a Market Maker should not effect purchases or sales on the ISE Mercury except in a reasonable and orderly manner. See id.

<sup>213</sup> See ISE Mercury Rule 805(b)(2).

<sup>214</sup> See ISE Mercury Rule 805(b)(3).

maker, such Market Maker may be subject to suspension or termination.<sup>215</sup> ISE Mercury may suspend or terminate any appointment of a Market Maker under ISE Mercury Rule 802 and may make additional appointments whenever, in ISE Mercury’s judgment, the interests of a fair and orderly market are best served by such action.<sup>216</sup>

Although Market Makers have a number of obligations, Market Makers also receive certain benefits for carrying out their responsibilities.<sup>217</sup> For example, a broker-dealer or other lender may extend “good faith” credit to a member of a national securities exchange or registered broker-dealer to finance its activities as a market maker or specialist.<sup>218</sup> PMMs are also entitled to certain participation entitlements.<sup>219</sup> In addition, market makers are excepted from the prohibition in Section 11(a) of the Act.<sup>220</sup>

The Commission believes that a market maker must be subject to sufficient and commensurate affirmative obligations, including the obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis, to justify favorable treatment.<sup>221</sup> The Commission further believes that the rules of all U.S. options markets need not provide the same standards for market maker participation, so long as they impose affirmative

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<sup>215</sup> See ISE Mercury Rule 800(c).

<sup>216</sup> See ISE Mercury Rule 802(d).

<sup>217</sup> See, e.g., ISE Gemini Order, supra note 27; MIAX Order, supra note 28 (discussing the benefits and obligations of market makers).

<sup>218</sup> See 12 CFR 221.5 and 12 CFR 220.7; see also 17 CFR 240.15c3-1(a)(6) (capital requirements for market makers).

<sup>219</sup> See ISE Mercury Rule 713, Supplementary Material .01(b)-(c). See also infra notes 248-255 and accompanying text (describing the PMM participation entitlements).

<sup>220</sup> 15 U.S.C. 78k(a).

<sup>221</sup> See ISE Gemini Order, supra note 27, at 78 FR 46635; MIAX Order, supra note 28, at 77 FR 73076; BOX Order supra note 37.

obligations that are consistent with the Act.<sup>222</sup> The Commission believes that ISE Mercury's Market Maker participation requirements impose appropriate affirmative obligations on ISE Mercury's Market Makers that are commensurate with the benefits afforded to such participants, as discussed above, and, accordingly, are consistent with the Act. The Commission believes that the specific levels of benefits conferred on the different classes of Market Makers are appropriately balanced by the obligations imposed by ISE Mercury's rules. The Commission further believes that ISE Mercury's market maker requirements,<sup>223</sup> which are identical to those of ISE and ISE Gemini<sup>224</sup> and similar to other options exchanges' rules,<sup>225</sup> impose sufficient appropriate obligations that are consistent with the Act. Finally, the Commission believes that the Act does not mandate a particular market model for exchanges, and while Market Makers may become an important source of liquidity on ISE Mercury, they will likely not be the only source as ISE Mercury is designed to match buying and selling interest of all ISE Mercury participants.

#### 4. Order Display, Execution, and Priority

ISE Mercury proposes to operate a fully automated electronic options trading platform to buy or sell securities with a continuous, automated matching function.<sup>226</sup> Liquidity will be derived from ISE Mercury members acting as principal or as agent electronically submitting

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<sup>222</sup> See id.

<sup>223</sup> See ISE Mercury Rule 803.

<sup>224</sup> See, e.g., ISE Rule 800 Series; ISE Gemini Rule 800 Series.

<sup>225</sup> See, e.g., ISE Gemini Order, supra note 27; MIAX Order, supra note 28; BOX Order, supra note 37.

<sup>226</sup> See Exhibit E to the Form 1 Application.

quotes as well as market and various types of limit orders to buy or to sell.<sup>227</sup> Non-members also may access ISE Mercury pursuant to ISE Mercury rules governing “sponsored access.”<sup>228</sup> All electronic submissions of quotes and orders to ISE Mercury will be from remote locations, as there will be no trading floor.<sup>229</sup> ISE Mercury’s system generally will automatically execute incoming orders.<sup>230</sup> Non-opening trades will occur when a buy order/quote and a sell order/quote match on the ISE Mercury’s order book.<sup>231</sup> All options will be traded in decimals on ISE Mercury and will be consistent with the Penny Pilot.<sup>232</sup>

All orders submitted to ISE Mercury’s trading platform must have a designated price and size (limit orders)<sup>233</sup> or must be orders to buy or sell a stated amount of a security at the national

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<sup>227</sup> See id.

<sup>228</sup> See id.

<sup>229</sup> See id.

<sup>230</sup> See ISE Mercury Rule 714.

<sup>231</sup> See Exhibit E to the Form 1 Application.

<sup>232</sup> See ISE Mercury Rule 710 and Supplementary Material .01. The Commission has approved exchange rules on a pilot basis that permit an exchange to quote series with premiums under \$3 in pennies and series with premiums of \$3 and over in nickels in approximately 360 options classes (“Penny Pilot”). In addition, these rules allow all series in QQQs, IWM, and SPY to be quoted in pennies. See, e.g., Securities Exchange Act Release Nos. 60711 (September 23, 2009), 74 FR 49419 (September 28, 2009); 61061 (November 24, 2009), 74 FR 62857 (December 1, 2009) (File No. SR-NYSEArca-2009-44) (approving Penny Pilot program expansions for NYSE Arca). Proposed Supplementary Material .01 to Rule 710 would permit ISE Mercury to operate a pilot to permit certain options classes to be quoted and traded in increments as low as \$0.01, consistent with these previously approved rules. Specifically, this pilot is consistent with the penny pilot on ISE Gemini, which was last extended on June 26, 2015 and is scheduled to expire on June 30, 2016. See Securities Exchange Act Release No. 75315 (June 26, 2015), 80 FR 38243 (July 2, 2015) (File No. SR-ISE Gemini-2015-12). Similar to ISE Gemini, ISE Mercury has further agreed to submit to the Commission such reports regarding the Penny Pilot as the Commission may request. See Exhibit B to the Form 1 Application.

<sup>233</sup> A limit order is an order to buy or sell a stated number of options contracts at a specified price or better. ISE Mercury Rule 715(b).

best bid or offer when the order reaches ISE Mercury (market orders).<sup>234</sup> Members may submit the following orders to ISE Mercury: Market Orders; Limit Orders (including Marketable Limit, Fill-or-Kill, Immediate or Cancel, Non-Displayed Penny Order, Sweep, Intermarket Sweep, and Stopped Orders);<sup>235</sup> or Contingency Orders (including All-Or-None, Stop, Stop Limit, Customer Participation, Reserve, Attributable, Customer Cross, Qualified Contingent Cross, Minimum Quantity, Do-Not-Route, Add Liquidity, Opening Only, and Good-Till-Date Orders).<sup>236</sup> Like

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<sup>234</sup> A market order is an order to buy or sell a stated number of options contracts that is to be executed at the best price obtainable when the order reaches ISE Mercury. ISE Mercury Rule 715(a).

<sup>235</sup> See ISE Mercury Rule 715. A Marketable Limit Order is a limit order to buy (sell) at or above (below) the best offer (bid) on the ISE Mercury. A Fill-or-Kill Order is a limit order that is to be executed in its entirety as soon as it is received and, if not so executed, treated as cancelled. An Immediate-or-Cancel Order is a limit order that is to be executed in whole or in part upon receipt and any portion not so executed is to be treated as cancelled. A Non-Displayed Penny Order is a limit order that specifies a one-cent price increment in a security that has a minimum trading increment pursuant to ISE Mercury Rule 710 that is larger than one-cent. A Sweep Order is a limit order that is executed in whole or in part on the exchange with the portion not executed routed pursuant to Supplementary Material .05 to ISE Mercury Rule 1901, which incorporates by reference ISE Rule 1901. An Intermarket Sweep Order is a limit order that meets the requirements of ISE Mercury Rule 1900(h), which incorporates by reference ISE Rule 1900(h). A Stopped Order is a limit order that meets the requirements of ISE Mercury Rule 1901(b)(8), which incorporates by reference ISE Rule 1901(b)(8). To execute Stopped Orders, members must enter them into the Facilitation Mechanism or Solicited Order Mechanism pursuant to ISE Mercury Rule 716.

<sup>236</sup> See ISE Mercury Rule 715. An All-or-None Order is a limit or market order that is to be executed in its entirety or not at all. A Stop Order is an order that becomes a market order when the stop price is elected. A Stop Limit Order is an order that becomes a limit order when the stop price is elected. A Customer Participation Order is a limit order on behalf of a Public Customer (as defined in ISE Mercury Rule 100(a)(38)) that, in addition to the limit order price in standard increments according to ISE Mercury Rule 710, includes a price stated in one-cent increments at which the Public Customer wishes to participate in trades executed in the same options series in penny increments through the Price Improvement Mechanism pursuant to ISE Mercury Rule 723. A Reserve Order is a limit order that contains both a displayed portion and a non-displayed portion. An Attributable Order is a market or limit order which displays the user firm ID for purposes of electronic trading on ISE Mercury. A Customer Cross Order is comprised of a Priority Customer Order (as defined in ISE Mercury Rule 100(a)(37B) to buy and a Priority

ISE, ISE Mercury also will permit flash mechanisms. Accordingly, certain orders will first be exposed at the National Best Bid or Offer (“NBBO”) to all ISE Mercury members for execution at the NBBO before an unaffiliated broker, under contract with ISE Mercury, routes the order to another market for execution.<sup>237</sup>

Quotes entered by PMMs and CMMs must, like Limit Orders, be priced and have a designated size.<sup>238</sup> Orders will be accepted for any security traded on ISE Mercury, whether submitted by a member on a proprietary or agency basis in any size,<sup>239</sup> whereas quotes for any security traded on ISE Mercury may only be submitted by PMMs and CMMs and only in the options classes to which the market makers are appointed.<sup>240</sup> ISE Mercury will be required to maintain a full audit trail of every incoming and outgoing message (including all orders and

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Customer Order to sell at the same price and for the same quantity. A Qualified Contingent Cross order is comprised of an order to buy or sell at least 1000 contracts that is identified as being part of a qualified contingent trade (as defined in ISE Mercury Rule 715, Supplementary Material .02) coupled with a contra-side order to buy or sell an equal number of contracts. A Minimum Quantity Order is an order that is initially available for partial execution only for a specified number of contracts or greater. A Do-Not-Route Order is a market or limit order that is to be executed in whole or in part on ISE Mercury only. An Add Liquidity Order is a limit order that is to be executed in whole or in part on ISE Mercury (i) only after being displayed on ISE Mercury’s limit order book; and (ii) without routing any portion of the order to another market center. An Opening Only Order is a limit order that can be entered for the opening rotation only. A Good-Till-Date Order is a limit order to buy or sell which, if not executed, will be cancelled at the sooner of the end of the expiration date assigned to the order, or the expiration of the series. These order types are the same order types that are available on ISE, except that ISE also includes several complex order types that are not proposed for ISE Mercury. See ISE Mercury Rule 715; ISE Rules 715 and 722; see also Exhibit B to the Form 1 Application.

<sup>237</sup> See ISE Mercury Rule 1901, Supplementary Material .02 (which incorporates by reference ISE Rule 1901, Supplementary Material .02).

<sup>238</sup> See ISE Mercury Rule 804(b).

<sup>239</sup> See ISE Mercury Rule 713(a).

<sup>240</sup> See ISE Mercury Rule 804(a).

quotes) submitted to the ISE Mercury's system.<sup>241</sup> Members may receive status reports regarding orders submitted to ISE Mercury or change or cancel an order at any time before that order is executed on ISE Mercury, except as otherwise specified in ISE Mercury Rule 723 (Price Improvement Mechanism for Crossing Transactions).<sup>242</sup>

All orders and quotes submitted to ISE Mercury will be displayed unless designated otherwise by the member submitting the order.<sup>243</sup> Displayed orders and quotes will be displayed on an anonymous basis (except for Attributable Orders,<sup>244</sup> which will allow voluntary disclosure of firm identification information) at a member's specified price. Non-Displayed Orders (the non-displayed portion of a Reserve Order or a Non-Displayed Penny Order) will not be displayed to anyone and will not have time priority over displayed orders at the same price.<sup>245</sup>

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<sup>241</sup> See 17 CFR 240.17a-5. See also Exhibit E to the Form 1 Application, Section C.

<sup>242</sup> See Exhibit E to the Form 1 Application, Section C.

<sup>243</sup> See ISE Mercury Rule 704.

<sup>244</sup> An Attributable Order is a market or limit order which displays the user firm's ID for purposes of trading on the ISE Mercury. See ISE Mercury Rule 715(h). Use of Attributable Orders would be voluntary. This order type is consistent with similar order types on other exchanges. See, e.g., ISE Gemini Rule 715(h); CBOE Rule 6.53(o) (attributable order type).

<sup>245</sup> See ISE Mercury Rules 715(b)(4) and 715(g).

ISE Mercury will utilize a pro-rata priority scheme with a Priority Customer preference.<sup>246</sup> This scheme is the same as what the Commission has approved for ISE and ISE Gemini.<sup>247</sup>

In addition, under ISE Mercury rules, PMMs are granted certain participation entitlements. For example, PMMs will be entitled to a participation entitlement with respect to each incoming order if they have a quote at the NBBO.<sup>248</sup> The PMM participation entitlement will apply only to any remaining balance after any Priority Customer<sup>249</sup> orders have first been satisfied.<sup>250</sup> The PMM will not be allocated a total quantity greater than the quantity it is quoting

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<sup>246</sup> See ISE Mercury Rule 713, Supplementary Material .01. Under this priority methodology, the highest bid and lowest offer will have priority except that Priority Customer Orders will have priority over professional interest and all market maker interest at the same price. Subject to certain limits, Professional Orders and market maker quotes at the best price receive allocations based upon the percentage of the total number of contracts available at the best price that is represented by the size of the Professional Order or quote. If there were two or more Priority Customer Orders for the same options series at the same price, priority will be afforded based on the sequence in which such orders were received. ISE Mercury rules will define “Priority Customer” as a person or entity that is not a broker or dealer in securities, and does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial accounts. “Professional Orders,” i.e., orders for the account of a person or entity that is not a Priority Customer, will be subordinate to Priority Customer Orders for priority and fee purposes. Professional Orders will include orders of broker-dealers and orders of those Public Customers that are not Priority Customers. See ISE Mercury Rules 100(a)(37A)-(37C) for definitions of Priority Customer, Priority Customer Order and Professional Order, respectively.

<sup>247</sup> See, e.g., ISE Rule 713; ISE Gemini Rule 713 (Priority of Quotes and Orders).

<sup>248</sup> See ISE Mercury Rule 713, Supplementary Material .01. Specifically, the PMM’s participation entitlement will be equal to the greater of: (i) the proportion of the total size at the best price represented by the size of its quote, or (ii) 60% of the contracts to be allocated if there is only one other Market Maker quotation at the NBBO or 40% if there are two or more other Market Maker quotes at the NBBO. See ISE Mercury Rule 713, Supplementary Material .01(b).

<sup>249</sup> See supra note 246 for the definition of Priority Customer.

<sup>250</sup> See ISE Mercury Rule 713, Supplementary Material .01.

at the execution price, and it will not receive any further allocation of an order if it receives a participation entitlement.<sup>251</sup> Moreover, if the PMM has a quote at the NBBO, small size orders (i.e., five or fewer contracts) will be allocated in full to the PMM.<sup>252</sup>

These participation entitlements for PMMs are consistent with provisions that the Commission has approved for other exchanges.<sup>253</sup> The Commission believes that these entitlements are appropriately balanced by the obligations imposed on these classes of market makers, as discussed in detail above.<sup>254</sup> In particular, PMMs are subject to higher quoting obligations than other Market Makers who are not eligible to receive the aforementioned participation entitlements.<sup>255</sup> Therefore, the Commission believes that the proposed rules regarding participation entitlements are consistent with the Act, including Section 6(b)(5),<sup>256</sup> in that they are designed 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.

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<sup>251</sup> See id.

<sup>252</sup> See ISE Mercury Rule 713, Supplementary Material .01(c). The rule provides that ISE Mercury will review the functioning of this provision quarterly to make sure that small size orders do not account for more than 40% of the volume executed on ISE Mercury. Id.

<sup>253</sup> See, e.g., ISE Gemini Order, supra note 27; MIAX Order, supra note 28.

<sup>254</sup> See supra Section 0 (discussing market maker obligations).

<sup>255</sup> For example, as discussed above, supra Section 0., PMMs must provide continuous two-sided quotes in each appointed option class.

<sup>256</sup> 15 U.S.C. 78f(b)(5).

ISE Mercury proposes to make available certain additional order processing and matching features, largely based on features available on ISE.<sup>257</sup> Mechanisms that will be utilized by ISE Mercury include: a Price Improvement Mechanism (which affords the opportunity for price improvement after an auction for eligible orders above the NBBO);<sup>258</sup> a Facilitation Mechanism (which affords members an opportunity to cross orders after an auction and provides the facilitating member the opportunity to receive 40% of the agency order);<sup>259</sup> and a Solicited Order Mechanism (which allows members representing agency orders the opportunity to cross large size solicited orders after an auction).<sup>260</sup> These mechanisms are consistent with substantially similar mechanisms currently existing on other options exchanges, including identical mechanisms on ISE and ISE Gemini.<sup>261</sup>

Members will be able to access ISE Mercury through a variety of electronic systems, and non-members will be able to access ISE Mercury pursuant to sponsored access arrangements with ISE Mercury members, pursuant to ISE Mercury rules.<sup>262</sup> As noted above and provided further below, prior to commencing operations, ISE Mercury also must become a participant in the Linkage Plan.<sup>263</sup> The manner in which ISE Mercury proposes to comply with the Linkage

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<sup>257</sup> The primary difference between ISE Mercury's order processing and matching features and those of ISE previously approved by the Commission will be that ISE Mercury will not accept complex orders.

<sup>258</sup> See ISE Mercury Rule 723. ISE Mercury will operate a pilot program whereby there will be no minimum size requirements for orders to be eligible for the PIM. See Exhibit B to the Form 1 Application; see also ISE Mercury Rule 723, Supplementary Material .03.

<sup>259</sup> See ISE Mercury Rule 716(d).

<sup>260</sup> See ISE Mercury Rule 716(e).

<sup>261</sup> See ISE Rules 716 and 723; ISE Gemini Rules 716 and 723.

<sup>262</sup> See, e.g., ISE Mercury Rule 706, Supplementary Material .01.

<sup>263</sup> See ISE Mercury Rule 1900 Series, which incorporates by reference ISE Rule 1900 Series.

Plan is identical to the manner in which ISE and ISE Gemini comply with the Linkage Plan. Specifically, to comply with the Linkage Plan, ISE Mercury, among other things, will prohibit its members from effecting a transaction at a price that is inferior to the NBBO, unless an exception applies.<sup>264</sup> ISE Mercury will provide a centralized process for sending intermarket sweep orders to other exchanges on behalf of Public Customer Orders.<sup>265</sup> ISE Mercury will contract with one or more unaffiliated brokers to route orders to other exchanges when necessary to comply with the Linkage Plan. In circumstances where marketable orders are received when ISE Mercury is not at the NBBO or orders are received that would lock or cross another market, they will be exposed to ISE Mercury members for up to one second.<sup>266</sup> If, after an order is exposed, such order cannot be executed in full on ISE Mercury at the then-current NBBO or better and is marketable, the lesser of the full displayed size of the protected bid(s) or protected offer(s) that are priced better than the ISE Mercury's quote or the balance of the order will be sent to a contracted unaffiliated broker, and any additional balance of the order that is not marketable against the then-current NBBO will be placed on the ISE Mercury book.<sup>267</sup>

The Commission believes that ISE Mercury's proposed display, execution, and priority rules are consistent with the Act. In particular, the Commission finds that the proposed rules are consistent with Section 6(b)(5) of the Act,<sup>268</sup> which, among other things, requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to

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<sup>264</sup> See ISE Mercury Rule 714(a); see also ISE Rule 714(a); ISE Gemini Rule 714(a).

<sup>265</sup> See ISE Mercury Rule 1901, which incorporates by reference ISE Rule 1901.

<sup>266</sup> See ISE Mercury Rule 1901, Supplementary Material .02, which incorporates by reference ISE Rule 1901, Supplementary Material .02.

<sup>267</sup> See id. Any additional balance of the order will be executed on ISE Mercury if it is marketable.

<sup>268</sup> 15 U.S.C. 78f(b)(5).

foster cooperation and coordination with persons engaged in regulating transactions in securities, 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, and to not permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission also finds that the proposed rules are consistent with Section 6(b)(8) of the Act,<sup>269</sup> which requires that the rules of an exchange not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The trading rules of ISE Mercury are substantially similar to the current ISE and ISE Gemini trading rules, which were approved at the time each of ISE and ISE Gemini's registration as a national securities exchange was granted<sup>270</sup> or filed with and approved by the Commission (or otherwise became effective) pursuant to Section 19(b) of the Act.<sup>271</sup>

#### 5. Section 11(a) of the Act

Section 11(a)(1) of the Act<sup>272</sup> prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises investment discretion (collectively, "covered accounts"), unless an exception applies. The Exchange has represented that it has analyzed its rules proposed hereunder, and believes that they are consistent with Section 11(a) of

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<sup>269</sup> 15 U.S.C. 78f(b)(8).

<sup>270</sup> See ISE Order, supra note 157; ISE Gemini Order, supra note 27.

<sup>271</sup> The Commission notes, however, that some of ISE Mercury's rules differ in some respects from the rules of ISE and ISE Gemini. For example, ISE Mercury is not proposing to incorporate ISE's rules relating to the trading of equity securities or to incorporate any rules concerning the trading of complex or multi-legged orders at this time.

<sup>272</sup> 15 U.S.C. 78k(a)(1).

the Act and rules thereunder.<sup>273</sup> For the reasons set forth below, based on ISE Mercury’s representations, the Commission believes that ISE Mercury’s order execution algorithm, including the Facilitation, Solicitation, Price Improvement Mechanism, and Customer Cross processes, will allow members to meet the requirements of Rule 11a2-2(T) for executions on ISE Mercury.

Rule 11a2-2(T) under the Act,<sup>274</sup> known as the “effect versus execute” rule, provides exchange members with an exemption from the Section 11(a)(1) prohibition. Rule 11a2-2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with Rule 11a2-2(T)’s conditions, a member: (i) may not be associated with the executing member; (ii) must transmit the order from off the exchange floor; (iii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;<sup>275</sup> and (iv) with respect to an account over which the member or an associated person has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule.

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<sup>273</sup> See Letter from Michael Simon, General Counsel, Secretary and Chief Regulatory Officer, ISE Mercury, to Brent J. Fields, Secretary, Commission, dated January 7, 2016 (“Exchange 11(a) Request Letter”).

<sup>274</sup> 17 CFR 240.11a2-2(T).

<sup>275</sup> This prohibition also applies to associated persons. See 15 U.S.C. 78f(b)(8). The member may, however, participate in clearing and settling the transaction. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (regarding the NYSE’s Designated Order Turnaround System) (“1978 Release”).

In a letter to the Commission,<sup>276</sup> ISE Mercury requested that the Commission concur with its conclusion that ISE Mercury members that enter orders through the ISE Mercury system, including the Facilitation, Solicitation, Price Improvement Mechanism, and Customer Cross processes, satisfy the requirements of Rule 11a2-2(T). For the reasons set forth below, the Commission believes that ISE Mercury members that enter orders through the ISE Mercury system, including through these processes, will satisfy the conditions of Rule 11a2-2(T).

Rule 11a2-2(T)'s first condition is that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that the requirement is satisfied when automated exchange facilities are used, such as the ISE Mercury system, as long as the design of these systems ensures that members do not possess any special or unique trading advantages over non-members in handling their orders after transmitting them to the Exchange.<sup>277</sup> ISE Mercury has represented that the design of the ISE Mercury system ensures that no member has any special or unique trading advantage in the handling of its orders after transmitting its orders to ISE Mercury.<sup>278</sup> Based on the Exchange's representation, the

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<sup>276</sup> See Exchange 11(a) Request Letter, *supra* note 273.

<sup>277</sup> In considering the operation of automated execution systems operated by an exchange, the Commission noted that while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted into each system. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See Securities Exchange Act Release No. 15533 (January 29, 1979), 44 FR 6084, 6086 n.25 (January 31, 1979) (File No. S7-613) (regarding the Amex Post Execution Reporting System, the Amex Switching System, the Intermarket Trading System, the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange, the PCX Communications and Execution System, and the Philadelphia Stock Exchange Automated Communications and Execution System ("1979 Release")).

<sup>278</sup> See Exchange 11(a) Request Letter, *supra* note 273.

Commission believes that the ISE Mercury system is designed to enable its members to satisfy this requirement.

Second, Rule 11a2-2(T) requires orders for covered accounts to be transmitted from off the exchange floor. ISE Mercury will not have a physical trading floor, and like other automated systems, will receive orders electronically through remote terminals or computer-to-computer interfaces. In the context of other automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.<sup>279</sup> Orders sent to ISE Mercury, regardless of where it executes within the ISE Mercury system, will be transmitted from remote terminals directly to ISE Mercury by electronic means. Since the ISE Mercury trading system receives all orders electronically, the Commission believes that the ISE Mercury system will satisfy the off-floor transmission requirement.

Third, Rule 11a2-2(T) requires that the member and any associated person not participate in the execution of its order once it has been transmitted to the member performing the execution.<sup>280</sup> ISE Mercury represents that at no time following the submission of an order is a

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<sup>279</sup> See, e.g., Securities Exchange Act Release Nos. 59154 (December 23, 2008) 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (order approving proposed rules of BX); 49068, (January 13, 2004), 69 FR 2775 (January 20, 2004) (SR-BSE-2002-15) (establishing, among other things, BOX as an options trading facility of BSE); 44983, (October 25, 2001), 66 FR 55225 (November 1, 2001) (SR-PCX-00-25) (approving the PCX's use of the Archipelago Exchange as its equity trading facility); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (SR-NYSE-90-52 and SR-NYSE-90-53) (regarding NYSE's Off-Hours Trading Facility). See 1978 Release, supra note 275. See also 1979 Release, supra note 277.

<sup>280</sup> The member may cancel or modify the order, or modify the instructions for executing the order, but only from off the Exchange floor. See 1978 Release, supra note 275, at 43 FR 11547. The Commission has stated that the non-participation requirement is satisfied under such circumstances so long as such modifications or cancellations are also transmitted from off the floor. See id. (stating that the "non-participation requirement

member able to acquire control or influence over the result or timing of an order's execution. According to ISE Mercury, orders submitted through ISE Mercury systems meet the non-participation requirement. Trades on ISE Mercury will execute when orders or quotations on ISE Mercury match one another based on their priority. Execution will not depend on the participant, but rather upon what other orders are entered into the system at or around the same time as the subject order, what orders are on ISE Mercury, or submitted as responses, and where the order is ranked based on priority ranking algorithm.<sup>281</sup> Accordingly, the Commission believes that the non-participation requirement will be met when orders are executed automatically through use of the ISE Mercury system.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T).<sup>282</sup> ISE Mercury members trading for covered accounts over which they exercise

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does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor”).

<sup>281</sup> See Exchange 11(a) Request Letter, supra note 273.

<sup>282</sup> 17 CFR 240.11a2-2(T)(a)(2)(iv). In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated person thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member or any associated person thereof in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d). See also 1978 Release, supra note 275, at 43 FR 11548 (stating “[t]he contractual and disclosure requirements are designed to assure that

investment discretion must comply with this condition in order to rely on the rule's exemption.<sup>283</sup>

E. Discipline and Oversight of Members

As noted above, one prerequisite for the Commission's grant of an exchange's application for registration is that a proposed exchange must be so organized and have the capacity to be able to carry out the purposes of the Act.<sup>284</sup> Specifically, an exchange must be able to enforce compliance by its members and persons associated with its members with the Act and the rules and regulations thereunder and the rules of the exchange.<sup>285</sup>

ISE Mercury rules codify ISE Mercury's disciplinary jurisdiction over its members, thereby facilitating its ability to enforce its members' compliance with its rules and the federal securities laws.<sup>286</sup> ISE Mercury's rules permit it to sanction members for violations of the Act and the rules and regulation thereunder and ISE Mercury's rules by, among other things, expelling or suspending members; limiting members' activities, functions, or operations; fining or censuring members; suspending or barring a person from being associated with a member; or any other fitting sanction in accordance with ISE Mercury rules.<sup>287</sup>

ISE Mercury's disciplinary and oversight functions will be administered in accordance with Chapter 16 of the ISE Mercury rules, which incorporates by reference Chapter 16 of ISE rules, governing disciplinary jurisdiction. Unless delegated to another SRO pursuant to the terms

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accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

<sup>283</sup> See Exchange 11(a) Request Letter, supra note 273.

<sup>284</sup> See 15 U.S.C. 78f(b)(1).

<sup>285</sup> See id.

<sup>286</sup> See ISE Mercury Rule 1600(a) (which incorporates by reference ISE Rule 1600(a)).

<sup>287</sup> See id. See also ISE Gemini Rule 1600(a); MIAX Rule 1000; BOX Exchange Rule 12000 Series (containing identical provisions).

of an effective 17d-2 Plan,<sup>288</sup> ISE Mercury regulatory staff (including regulatory staff of another SRO that may be acting on ISE Mercury's behalf pursuant to a regulatory services agreement) will, among other things, investigate potential securities laws violations and initiate charges pursuant to ISE Mercury rules.<sup>289</sup>

Upon a finding of probable cause of a violation within the disciplinary jurisdiction of ISE Mercury and where further proceedings are warranted,<sup>290</sup> ISE Mercury will conduct a hearing on disciplinary matters before a professional hearing officer<sup>291</sup> and two members of the Business Conduct Committee<sup>292</sup> ("Panel").<sup>293</sup> The ISE Mercury member (or its associated person) or the

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<sup>288</sup> See supra notes 144-146 and accompanying text (concerning the multiparty 17d-2 Plans to which ISE Mercury has committed to join).

<sup>289</sup> See ISE Mercury Rule 1602 (which incorporates by reference ISE Rule 1602). As noted above, ISE Mercury has entered into an RSA with FINRA and a FMA with ISE under which FINRA and ISE, respectively, will perform certain regulatory functions on behalf of ISE Mercury. See ISE Mercury Rule 1615 (which incorporates by reference ISE Rule 1615).

<sup>290</sup> See ISE Mercury Rule 1604 (which incorporates by reference ISE Rule 1604). If there is probable cause for finding a violation, ISE Mercury's regulatory staff will prepare a statement of charges including the allegations and specifying the provisions of the Act and the rules and regulations promulgated thereunder, provisions of the ISE Mercury Constitution or rules, or interpretations or resolutions of which such acts are in violation. The CRO must approve the statement of charges.

<sup>291</sup> See ISE Mercury Rule 1606 (which incorporates by reference ISE Rule 1606); see also ISE Mercury Rule 1615, Supplemental Material .01 (which incorporates by reference ISE Rule 1615, Supplemental Material .01).

<sup>292</sup> Pursuant to a Resolution of the ISE Mercury Board, the President and CEO shall establish ISE Mercury's Business Conduct Committee, pursuant to a charter. The Committee shall consist of no more than 21 persons, all of whom are employees of members of ISE Mercury, representing members as follows: at least three persons shall represent PMMs; at least three persons shall represent CMMs that are not also PMMs; and at least four persons shall represent EAMs that neither are, nor are affiliated with, a PMM or CMM. See Exhibit L to the Form 1 Application.

<sup>293</sup> See ISE Mercury Rule 1606 (which incorporates by reference ISE Rule 1606). A Panel may make a determination without a hearing and may impose a penalty as to violations that the member or associated person has admitted or has failed to answer or that

ISE Mercury regulatory staff may petition for review of the Panel's decision by the ISE Mercury Board.<sup>294</sup> Any review will be conducted by the ISE Mercury Board or a committee thereof composed of at least three of its directors (whose decision must be ratified by the ISE Mercury Board).<sup>295</sup> In addition, the ISE Mercury Board on its own motion may order review of a disciplinary decision.<sup>296</sup> The ISE Mercury Board may affirm, reverse, or modify, in whole or in part, the Panel's decision.<sup>297</sup> The decision of the ISE Mercury Board will be in writing and will be final.<sup>298</sup>

Appeals from any determination that impacts access to ISE Mercury, such as termination or suspension of membership, will be instituted under, and governed by, the provisions in Chapter 17 of the ISE Mercury rules, which incorporate by reference the provisions in Chapter 17 of ISE rules. ISE Mercury's Chapter 17 applies to persons economically aggrieved by any of the following actions of ISE Mercury including, but not limited to: (a) denial of an application to become a member; (b) barring a person from becoming associated with a member; and (c)

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otherwise do not appear to be in dispute. See ISE Mercury Rule 1608 (which incorporates by reference ISE Rule 1608). A member or associated person alleged to have committed a disciplinary violation may submit a written offer of settlement to the Panel, or CRO if a Panel is not yet been appointed, which the Panel or CRO may accept or reject. See ISE Mercury Rule 1609 (which incorporates by reference ISE Rule 1609). If the second offer of settlement is rejected (such decision is not subject to review), a hearing will proceed in accordance with ISE Mercury Rule 1606 (which incorporates by reference ISE Rule 1606). See also ISE Mercury Rule 1609 (which incorporates by reference ISE Rule 1609).

<sup>294</sup> See ISE Mercury Rule 1610 (which incorporates by reference ISE Rule 1610).

<sup>295</sup> See id.

<sup>296</sup> See id.

<sup>297</sup> See id.

<sup>298</sup> See id.

limiting or prohibiting services provided by the ISE Mercury or services of any exchange member.<sup>299</sup>

Any person aggrieved by an action of ISE Mercury within the scope of the Chapter 17 may file a written application to be heard within thirty days<sup>300</sup> after such action has been taken.<sup>301</sup> Applications for hearing and review will be referred to the Business Conduct Committee, which will appoint a hearing panel of no less than three members of such Committee.<sup>302</sup> The decision of the hearing panel made pursuant to Chapter 17 of the ISE Mercury rules is subject to review by the ISE Mercury Board, either on its own motion, or upon written request submitted by the applicant or the President of ISE Mercury.<sup>303</sup> The review will be conducted by the ISE Mercury Board or a committee of the ISE Mercury Board composed of at least three directors.<sup>304</sup>

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<sup>299</sup> See ISE Mercury Rule 1700 (which incorporates by reference ISE Rule 1700). As noted above, ISE Mercury has entered into an RSA with FINRA and a FMA with ISE under which FINRA and ISE, respectively, will perform certain regulatory functions on behalf of ISE Mercury. For example, FINRA may perform some or all of the functions specified in Chapter 17 of ISE Mercury rules. See supra notes 148-149 and accompanying text. See also ISE Mercury Rule 1706 (which incorporates by reference ISE Rule 1706).

<sup>300</sup> An applicant may file for an extension of time within thirty days of ISE Mercury's action. An application for such an extension will be ruled upon by the Chairman of the Business Conduct Committee and is not subject to appeal. See ISE Mercury Rule 1701 (which incorporates by reference ISE Rule 1701).

<sup>301</sup> See ISE Mercury Rule 1701 (which incorporates by reference ISE Rule 1701).

<sup>302</sup> See ISE Mercury Rule 1702 (which incorporates by reference ISE Rule 1702).

<sup>303</sup> See ISE Mercury Rule 1704 (which incorporates by reference ISE Rule 1704). The ISE Mercury Board, or a committee of the ISE Mercury Board, will have sole discretion to grant or deny either request. See id.

<sup>304</sup> See ISE Mercury Rule 1704 (which incorporates by reference ISE Rule 1704). The ISE Mercury Board or its designated committee may affirm, reverse, or modify in whole or in part, the decision of the hearing panel. The decision of the ISE Mercury Board or its

The Commission finds that ISE Mercury’s proposed disciplinary and oversight rules and structure, as well as its proposed process for persons economically aggrieved by certain ISE Mercury actions, are consistent with the requirements of Sections 6(b)(6) and 6(b)(7) of the Act<sup>305</sup> in that they provide fair procedures for the disciplining of members and persons associated with members. The Commission further finds that the proposed ISE Mercury rules, which incorporate by reference ISE rules, are designed to provide ISE Mercury with the ability to comply, and with the authority to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of ISE Mercury.<sup>306</sup> The Commission notes that ISE Mercury’s proposed disciplinary and oversight rules and structures are similar to the rules of other exchanges.<sup>307</sup>

F. Listing Requirements

ISE Mercury does not intend to offer original listings when it commences operations. Instead, ISE Mercury will list and trade only standardized option contracts that are listed on other national securities exchanges and cleared by the Options Clearing Corporation.<sup>308</sup> ISE Mercury’s listing rules, including the criteria for the underlying securities of the options to be traded, incorporate by reference all of the listing rules of ISE.<sup>309</sup>

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designated committee will be in writing and will be final. See ISE Mercury Rule 1704 (which incorporates by reference ISE Rule 1704).

<sup>305</sup> 15 U.S.C. 78f(b)(6) and (b)(7), respectively.

<sup>306</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>307</sup> See, e.g., ISE Gemini Order, supra note 27; MIAX Order, supra note 28; and BOX Order, supra note 37.

<sup>308</sup> See Exhibit H to the Form 1 Application.

<sup>309</sup> See ISE Mercury Rule 500 Series (which incorporates by reference ISE Rule 500 Series) (Securities Traded on the Exchange). See also ISE Gemini Rule 500 Series; MIAX Rule 400 Series; and BOX Rule 5000 Series.

The Commission finds that ISE Mercury’s proposed initial and continued listing rules are consistent with the Act, including Section 6(b)(5),<sup>310</sup> in that they are designed to protect investors and the public interest, prevent fraudulent and manipulative acts and practices, and promote just and equitable principles of trade. Before beginning operation, ISE Mercury will need to become a participant in the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options Submitted Pursuant to Section 11A(a)(3)(B) of the Act (“OLPP”).<sup>311</sup> In addition, before beginning operation, ISE Mercury will need to become a participant in the Options Clearing Corporation.

G. Limitation on Liability

ISE Mercury proposes to adopt a rule providing that, in general, ISE Mercury will not be liable for any losses arising from the use of exchange facilities, systems, or equipment.<sup>312</sup> The rule also states that ISE Mercury may compensate its members for certain identified losses resulting directly from the malfunction of ISE Mercury’s physical equipment, devices and/or programming.<sup>313</sup> Under the rule, ISE Mercury’s aggregated payments for all claims on a single trading day would not exceed \$250,000, and this amount will be allocated proportionally among all claims if the claims arising on a single trading day exceeded \$250,000.

The Commission finds that ISE Mercury’s proposed rule regarding limitation of liability is consistent with the requirements of Section 6(b)(5)<sup>314</sup> of the Act in that it is designed to

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<sup>310</sup> 15 U.S.C. 78f(b)(5).

<sup>311</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>312</sup> See proposed Rules of ISE Mercury, Chapter 7, Rule 705, Exhibit B.

<sup>313</sup> NASDAQ and NYSE Arca also provide that the exchanges may compensate their members for certain identified losses resulting from the malfunction of their respective systems. See NASDAQ Rule 4626; NYSE Arca (Options) Rule 14.2.

<sup>314</sup> 15 U.S.C. 78f(b)(5).

promote just and equitable principles of trade and to not permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission notes that ISE Mercury’s proposed limitation of liability is similar to the limitations of other exchanges, including ISE and ISE Gemini.<sup>315</sup>

H. Comment

As noted above, the Commission received one comment letter regarding the Form 1 Application. In its letter, Wolverine recommends that the Commission disapprove the Form 1 Application.<sup>316</sup> In particular, Wolverine asserts that an approval of a new options exchange would further fragment existing options liquidity and hinder best execution for market participants.<sup>317</sup> Additionally, Wolverine argues that the creation of another options exchange would impose additional costs on the industry without providing a sufficient benefit.<sup>318</sup> For example, Wolverine states that approval of a new options exchange would impose additional cost on the industry through the assessment of Options Regulatory Fees (“ORFs”).<sup>319</sup>

In response, ISE Mercury provides that the “comment letter does not raise any new issues unique to the creation of ISE Mercury.”<sup>320</sup> The Exchange asserts that new options exchanges are necessary “to provide customers with additional choices related to fees and market structure.”<sup>321</sup>

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<sup>315</sup> The proposed rule is identical to ISE Rule 705 and ISE Gemini Rule 705. See also Securities Exchange Act Release No. 57675 (April 17, 2008), 73 FR 21996 (April 23, 2008) (noting that the approved ISE rule, as approved, was generally similar to NASDAQ Rule 4626(b) and NYSE Arca Rules 14.2(b) and (c)).

<sup>316</sup> See Wolverine Letter, supra note 5.

<sup>317</sup> See id.

<sup>318</sup> See id.

<sup>319</sup> See id.

<sup>320</sup> See ISE Mercury Response Letter, supra note 6.

<sup>321</sup> See id.

The Exchange also highlighted that “there are much fewer options exchanges in comparison to the many registered equity exchanges, ECNs, and ATSSs, and this is partly why there continues to be an influx of new options exchanges.”<sup>322</sup> Finally, ISE Mercury notes that ORFs are applied consistently across the options industry (not specific to ISE Mercury) and are designed to make options regulatory structure stronger.<sup>323</sup> The Exchange also emphasizes that if ISE Mercury determines to propose an ORF for its market, Wolverine and all other market participants will have an opportunity to comment on such proposal at that time.<sup>324</sup>

The Commission believes that ISE Mercury has sufficiently addressed the principal concerns raised by the commenter. The Commission acknowledges the concerns that were raised by the commenter regarding possible impacts resulting from potential market fragmentation that may result from the approval of the Form 1 Application. However, the Commission also notes that the commenter did not identify any specific Exchange Act provision or rule or regulation thereunder that would be inconsistent with the approval of the Form 1 Application. Although the Commission continuously considers issues related to market structure – including the issues raised by the commenter – pursuant to Sections 6 and 19 of the Exchange Act, the Commission must grant an application for registration as a national securities exchange if it finds that the requirements of the Exchange Act and the rules and regulations thereunder with respect to the applicant are satisfied.<sup>325</sup> For the reasons discussed throughout the order, the Commission believes that these requirements have been met. Finally, the Commission also notes

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<sup>322</sup> See id.

<sup>323</sup> See id.

<sup>324</sup> See id.

<sup>325</sup> See 15 U.S.C. 78f(b); 15 U.S.C. 78s(a)(1).

that the commenter's concern regarding an increased ORF is not ripe for consideration until ISE Mercury proposes such a separate fee.

III. Exemption from Section 19(b) of the Act With Regard to ISE, CBOE, New York Stock Exchange LLC ("NYSE"), and FINRA Rules Incorporated by Reference

ISE Mercury proposes to incorporate by reference certain ISE, CBOE, NYSE and FINRA rules.<sup>326</sup> Thus, for certain ISE Mercury rules, ISE Mercury members will comply with an ISE Mercury rule by complying with the referenced ISE, CBOE, NYSE or FINRA rule.

In connection with the proposal to incorporate ISE, CBOE, NYSE and FINRA rules by reference, ISE Mercury requests, pursuant to Rule 240.0-12 under the Act,<sup>327</sup> an exemption under Section 36 of the Act from the rule filing requirements of Section 19(b) of the Act for changes to the ISE Mercury rules that are effected solely by virtue of a change to a cross-referenced ISE, CBOE, NYSE or FINRA rule.<sup>328</sup> ISE Mercury proposes to incorporate by reference categories of rules, rather than individual rules within a category, that are not trading rules. In addition, ISE Mercury agrees to provide written notice to its members whenever

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<sup>326</sup> Specifically, ISE Mercury proposes to incorporate by reference the following ISE Rules: Chapter 4 (Business Conduct), Chapter 5 (Securities Traded on the Exchange), Chapter 6 (Doing Business with the Public), Chapter 10 (Closing Transactions), Chapter 11 (Exercises and Deliveries), Chapter 12 (Margins), Chapter 13 (Net Capital Requirements), Chapter 14 (Records, Reports and Audits), Chapter 15 (Summary Suspension), Chapter 16 (Discipline), Chapter 17 (Hearings and Review), Chapter 18 (Arbitration), Chapter 19 (Order Protection; Locked and Crossed Markets), Chapter 20 (Index Rules), Chapter 22 (Rate-Modified Foreign Currency Options Rules). The following rules are cross-referenced in the ISE rules: ISE Rule 1202 (Margin Requirements) cross-references the same CBOE and NYSE rules that may be in effect from time to time; ISE Rule 1615 (Disciplinary Functions) cross-references the FINRA Code of Procedure and ISE Rule 1800 cross-references the 12000 and 13000 Series of the FINRA Manual and FINRA Rule 2268.

<sup>327</sup> 17 CFR 240.0-12.

<sup>328</sup> See Letter from Michael Simon, General Counsel, Secretary and Chief Regulatory Officer, ISE Mercury, to Brent J. Fields, Secretary, Commission, dated June 26, 2015.

FINRA, ISE, CBOE or NYSE proposes a change to a cross-referenced rule<sup>329</sup> and whenever any such proposed changes are approved by the Commission or otherwise become effective.<sup>330</sup>

Using the authority under Section 36 of the Act, the Commission previously exempted certain SROs from the requirement to file proposed rule changes under Section 19(b) of the Act.<sup>331</sup> The Commission is hereby granting ISE Mercury's request for exemption, pursuant to Section 36 of the Act, from the rule filing requirements of Section 19(b) of the Act with respect to the rules that ISE Mercury proposes to incorporate by reference. The exemption is conditioned upon ISE Mercury providing written notice to ISE Mercury members whenever FINRA, ISE, CBOE or NYSE proposes to change an incorporated by reference rule and when the Commission approves any such changes. The Commission believes that the exemption is appropriate in the public interest and consistent with the protection of investors because it will promote more efficient use of Commission's and SROs' resources by avoiding duplicative rule filings based on simultaneous changes to identical rule text sought to be implemented by more than one SRO.

#### IV. Conclusion

IT IS ORDERED that the application of ISE Mercury for registration as a national securities exchange be, and it hereby is, granted.

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<sup>329</sup> See id.

<sup>330</sup> ISE Mercury will provide such notice through a posting on the same website location where ISE Mercury posts its own rule filings pursuant to Rule 19b-4 under the Act, within the required time frame. The website posting will include a link to the location on the FINRA, ISE, CBOE or NYSE website where FINRA, ISE, CBOE or NYSE's proposed rule change is posted. See id.

<sup>331</sup> See, e.g., BATS Order, supra note 27, C2 Order, supra note 159, Nasdaq Order, supra note 27, and NOM Approval Order, supra note 154.

IT IS FURTHERED ORDERED that operation of ISE Mercury is conditioned on the satisfaction of the requirements below:

A. Participation in National Market System Plans Relating to Options Trading. ISE Mercury must join: (1) The Plan for the Reporting of Consolidated Options Last Sale Reports and Quotation Information (Options Price Reporting Authority); (2) the OLPP; (3) the Linkage Plan; and (4) the Plan of the Options Regulatory Surveillance Authority.

B. Participation in Multiparty Rule 17d-2 Plans. ISE Mercury must become a party to the multiparty Rule 17d-2 agreements concerning options sales practice regulation and market surveillance.

C. Participation in the Options Clearing Corporation. ISE Mercury must become an Options Clearing Corporation participant exchange.

D. Participation in the Intermarket Surveillance Group. ISE Mercury must join the Intermarket Surveillance Group.

IT IS FURTHER ORDERED, pursuant to Section 36 of the Act,<sup>332</sup> that ISE Mercury shall be exempted from the rule filing requirements of Section 19(b) of the Act with respect to the FINRA, ISE, CBOE and NYSE rules that ISE Mercury proposes to incorporate by reference, subject to the conditions specified in this order that ISE Mercury provide written notice to ISE Mercury members whenever FINRA, ISE, CBOE or NYSE propose to change an incorporated by reference rule and when the Commission approves any such changes.

By the Commission.

Robert W. Errett  
Deputy Secretary

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<sup>332</sup> 15 U.S.C. 78mm.

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