

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>13</sup>

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-83238; File No. SR-ISE-2018-44]

### Self-Regulatory Organizations; Nasdaq ISE, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Amend Supplementary Material to Rule 706 To Harmonize Its Sponsored Access Rules With Those of Its Affiliates

May 15, 2018.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 9, 2018, Nasdaq ISE, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Supplementary Material to Rule 706 to harmonize its sponsored access rules with those of its affiliates, The Nasdaq Stock Market LLC (“NQX”), Nasdaq BX, Inc. (“BX”) and Nasdaq PHLX LLC (“PHLX,” and together with NQX and BX, “Nasdaq Exchanges”).

The text of the proposed rule change is available on the Exchange’s website at <http://ise.cchwallstreet.com/>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these

statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

##### 1. Purpose

The purpose of the proposed rule change is to amend Supplementary Material to Rule 706, which contains the Exchange’s sponsored access rules, to harmonize these rules with those of the Nasdaq Exchanges.<sup>3</sup> On March 9, 2016, the Exchange and its affiliates, ISE Gemini, LLC (now, Nasdaq GEMX, LLC) (“GEMX”) and ISE Mercury, LLC (now, Nasdaq MRX, LLC) (“MRX” and together with ISE and GEMX, “ISE Exchanges”), were acquired by Nasdaq, Inc. (“Acquisition”).<sup>4</sup> In the context of the Acquisition, the ISE Exchanges have been working to align certain of its rules and processes with those of the Nasdaq Exchanges in order to provide consistent standards across the six exchanges owned and operated by Nasdaq, Inc. (collectively, “Affiliated Exchanges”). As part of this effort, the proposal set forth below harmonizes the Exchange’s sponsored access rules with the Nasdaq Sponsored Access Rules in order to provide uniform standards and requirements for users of the Affiliated Exchanges.<sup>5</sup>

In particular, the Exchange proposes to (1) define the term “Sponsored Access” and “Customer Agreement;” (2) specify the requirement to comply with Rule 15c3-5 under the Act (“Market Access Rule”); (3) remove the requirements that each Sponsored Customer and each Sponsoring Member enter into certain agreements with the Exchange; and (4) make a number of related, non-substantive changes. Each change is discussed in detail as follows.

##### Defining Sponsored Access

A Sponsored Customer is a non-member of the Exchange, such as an institutional investor, that gains access to the Exchange<sup>6</sup> and trades under a

<sup>3</sup> See NQX Rule 4615, BX Rule 4615 and PHLX Rule 1094 (collectively, “Nasdaq Sponsored Access Rules”).

<sup>4</sup> See Securities Exchange Act Release No. 78119 (June 21, 2016), 81 FR 41611 (June 27, 2016) (SR-ISE-2016-11; SR-ISEGemini-2016-05; SR-ISEMercury-2016-10).

<sup>5</sup> GEMX and MRX will each file similar rule change proposals with the Commission to harmonize their sponsored access rules with the Nasdaq Sponsored Access Rules.

<sup>6</sup> For example, a broker-dealer may allow its customer—whether an institution such as a hedge

Sponsoring Member’s execution and clearing identity pursuant to a sponsorship arrangement between such non-member and Sponsoring Member, as set forth in Supplementary Material to Rule 706. The Exchange is proposing to define the term “Sponsored Access” to clarify the type of market access arrangement that is subject to this rule. Accordingly, the Exchange proposes to amend Supplementary Material .01(a) to Rule 706 to add the following definition: “Sponsored Access shall mean an arrangement whereby a Member permits its customers to enter orders into the System that bypass the Member’s trading system and are routed directly to the Exchange, including routing through a service bureau or other third party technology provider.” This definition mirrors the language set forth in the Nasdaq Sponsored Access Rules,<sup>7</sup> and is derived from the Commission’s description of Sponsored Access used in the release approving the Market Access Rule.<sup>8</sup> The Exchange believes that defining Sponsored Access in Supplementary Material .01(a) to Rule 706 will provide market participants with greater clarity regarding Sponsored Access and their obligations with respect to this type of access arrangement.

##### Defining Customer Agreement

The Exchange proposes to amend Supplementary Material .01(b)(1) to Rule 706 to define the agreement that Sponsored Customers must enter into and maintain with one or more Sponsoring Members to establish proper relationship(s) and account(s) through which the Sponsored Customer may trade on the Exchange, as a “Customer Agreement.”<sup>9</sup>

##### Market Access Rule

Pursuant to Supplementary Material .01(b)(2) to Rule 706, the Sponsoring Member is responsible for the activities

fund, mutual fund, bank or insurance company, an individual, or another broker-dealer—to use the broker-dealer’s MPID, account or other mechanism or mnemonic used to identify a market participant for the purposes of electronically accessing the Exchange.

<sup>7</sup> See NQX Rule 4615(a), BX Rule 4615(a) and PHLX Rule 1094(a).

<sup>8</sup> The Market Access Rule, among other things, requires broker-dealers providing others with access to an exchange or alternative trading system to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of providing such access. See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010).

<sup>9</sup> The Nasdaq Sponsored Access Rules also similarly define “Customer Agreement.” See NQX Rule 4615(b)(i), BX Rule 4615(b)(i) and PHLX Rule 1094(b)(i).

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

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

of the Sponsored Customer. Sponsored Customers are required to have procedures in place to comply with the Exchange's rules, and the Sponsoring Member takes responsibility for the Sponsored Customer's activity on the Exchange. Members may have multiple Sponsored Access relationships in place at a given time. The Exchange's examination program assesses compliance with the sponsored access rules set forth in Supplementary Material to Rule 706, among other rules.<sup>10</sup> The Exchange now proposes to specifically enumerate in Supplementary Material .01(b)(2) to Rule 706 the member's obligation to comply with the Market Access Rule, with which Members are currently required to comply in connection with market access.<sup>11</sup> The Exchange believes that specifying the obligation to comply with the Market Access Rule within the rule itself will reinforce that Supplementary Material to Rule 706 presupposes member compliance with the Market Access Rule.

#### Elimination of Certain Contract Requirements

The Exchange currently requires a Sponsored Customer Agreement between the Sponsored Customer and the Exchange,<sup>12</sup> and a Sponsored Customer Addendum to the member access agreement (hereinafter, "Addendum") that is provided to the Exchange by the Sponsoring Member.<sup>13</sup> At this time, the Exchange proposes to remove the existing requirements to submit the Sponsored Customer Agreement and Addendum to the Exchange in order to align its sponsored access rules with the Nasdaq Sponsored Access Rules. The Exchange will continue to require a Customer Agreement between the Sponsored Customer and Sponsoring Member pursuant to Supplementary Material .01(b)(2) to Rule 706.<sup>14</sup>

Today, only members may request connectivity to the Exchange by contacting Nasdaq Subscriber Services. A member may obtain separate ports for the purpose of providing Sponsored

Access. If separate ports are requested by a member for the purpose of providing Sponsored Access, the member must request those ports from the Exchange and is responsible for the Sponsored Customer's activity on the Exchange.<sup>15</sup> In all circumstances, the Exchange only permits members to request connectivity to the market and the member is responsible for all customer orders submitted through the member's port. In addition, such connection by the member requires approval by the Exchange for the purpose of testing as well as other relevant information sharing with the Exchange by the member to obtain a port. The Exchange is therefore aware of the member responsible for each of its ports. The Exchange may also request further information about a member's particular customer relationship, including the list of all Authorized Traders who may have access to the Exchange on behalf of the Sponsored Customer, as it deems necessary.<sup>16</sup>

The Exchange believes that completing and submitting the Sponsored Customer Agreement and Addendum is unnecessarily burdensome in light of the current structure in place at the Exchange. The Sponsored Customer Agreement requirement was intended to ensure that the Sponsored Customer was informed of its obligation to comply with the Exchange's Certificate of Formation, By-Laws, Rules and procedures, including the requirements in Supplementary Material .01(b)(2)(iii)–(ix).<sup>17</sup> The agreement also provided the Exchange with contractual privity, which would no longer exist with the removal of the Sponsored Customer Agreement. The Exchange does not believe the loss of privity with the Sponsored Customer creates a concern as the Exchange has the ability to remove access to the port at any time if it determines that the activity of the Sponsored Customer warrants such removal. In addition, as discussed below, the Sponsored

Customer will be informed of its obligations through the Customer Agreement that it executed with the Sponsoring Member. As noted above, the Exchange only permits its members to request connectivity to the Exchange's trading system, and members remain responsible for all trades submitted through such ports. Pursuant to Supplementary Material .01(b)(2)(vii) to Rule 706, the trading activity of a Sponsored Customer must be monitored by the Sponsoring Member for compliance with the terms of the Customer Agreement with the Sponsored Customer. Finally, Sponsoring Members continue to be obligated to comply with Supplementary Material .01(b) to Rule 706 and the Market Access Rule. As such, the Sponsoring Member is responsible for any and all actions taken by its Sponsored Customer and any person acting on behalf of or in the name of such Sponsored Customer.

The Addendum requirement was intended to notify the Exchange of the relationship between the Sponsoring Member and the Sponsored Customer, and to provide the Sponsoring Member's express acknowledgment of the Sponsoring Member's responsibility for the orders, executions and actions of its Sponsored Customer. However, as noted above, the Exchange may request additional information about a particular customer relationship as it deems necessary.<sup>18</sup> The Exchange will also require that its members disclose the Sponsored Customer relationship as a condition for approving any ports requested for the purpose of providing Sponsored Access.<sup>19</sup> Accordingly, the Exchange will continue to be notified of Sponsored Customer arrangements even with the removal of the Addendum. Furthermore, as discussed above, Sponsoring Members continue to be obligated to comply with Supplementary Material .01(b) to Rule 706 and the Market Access Rule, and are therefore responsible for any and all actions taken by its Sponsored Customer and any person acting on behalf of or in the name of such Sponsored Customer. The Exchange, through its RSA with FINRA, reviews member compliance with Supplementary Material to Rule 706, including compliance with the Market Access Rule.

Supplementary Material .01(b)(1) to Rule 706 requires that the Sponsored Customer and the Sponsoring Member maintain a Customer Agreement with the sponsorship provisions set forth in paragraph (2) to ensure compliance with

<sup>10</sup> The Exchange has a Regulatory Services Agreement ("RSA") with the Financial Industry Regulatory Authority ("FINRA") to conduct regulatory examinations, among other obligations.

<sup>11</sup> See NQX Rule 4615(b)(ii)(A), BX Rule 4615(b)(ii)(A) and PHLX Rule 1094(b)(ii)(A) for consistent provisions.

<sup>12</sup> See Supplementary Material .01(a) to Rule 706.

<sup>13</sup> See Supplementary Material .01(b)(2)(i) and (b)(3) to Rule 706.

<sup>14</sup> The Nasdaq Sponsored Access Rules likewise only require a Customer Agreement between the sponsored participant and sponsoring member. See NQX Rule 4615(b)(i), BX Rule 4615(b)(i) and PHLX Rule 1094(b)(i).

<sup>15</sup> In such cases, the Nasdaq Exchanges also require members to disclose the sponsored access arrangement as a condition to approving the member's port request. ISE will similarly require members requesting connectivity to ISE for the purpose of providing Sponsored Access to disclose sponsored access arrangements as a condition to approval.

<sup>16</sup> See Rule 1601.

<sup>17</sup> These requirements include, among others, the Sponsored Customer's obligation to maintain, keep current and provide to the Sponsoring Member a list of Authorized Traders who may obtain access to the Exchange on behalf of the Sponsored Customer. In addition, the Sponsored Customer must take reasonable security precautions to prevent unauthorized use or access to the Exchange, and is responsible for having adequate procedures and controls in place to comply with ISE's rules.

<sup>18</sup> See Rule 1601.

<sup>19</sup> See note 15 above.

Exchange's rules and obligations related to security, among other things. Additionally, Supplementary Material .01(b)(2)(iv) and (v) require that the Customer Agreement include the Sponsored Customer's obligation to maintain, keep current and provide to the Sponsoring Member a list of Authorized Traders who have been granted access to the Exchange on behalf of the Sponsored Customer, and provide such Authorized Traders with appropriate training prior to any use or access to the Exchange. In addition, pursuant to the Customer Agreement provisions required by Rule 706, Supplementary Material .01(b)(vii), the Sponsored Customer is obligated to take reasonable security precautions to prevent unauthorized use or access to the Exchange, including unauthorized entry of information into the Exchange's System, or the information and data made available therein. Finally, the Customer Agreement must provide that the Sponsored Customer is responsible for any and all orders, trades and other messages and instructions entered, transmitted or received under identifiers, passwords and security codes of Authorized Traders, and for the trading and other consequences thereof, including granting unauthorized access to the Exchange.<sup>20</sup> The contents and the requirement for a Customer Agreement are unchanged.

#### Clean-Up Changes

The Exchange proposes to correct two typographical errors in subsections (vii) and (ix) of Supplementary Material .01(b)(2) to Rule 706. First in subsection (vii), the Exchange proposes to correct a typo by replacing "of" with "or" in the first sentence. The proposed sentence would therefore state "Sponsored Customer shall take reasonable security precautions to prevent unauthorized use or access to the Exchange . . ."

Second, subsection (ix) would be amended to correct a typo in the last portion of the first sentence. In particular, the phrase ". . . Sponsored Customers access to and use of the Exchange" should be ". . . Sponsored Customer's access to and use of the Exchange." Both of these proposed changes are non-substantive clean-ups, and are intended to ensure that the rule text is as accurate and clear as possible.

#### 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>21</sup> in general, and furthers the

objectives of Section 6(b)(5) of the Act,<sup>22</sup> in particular, in that it is 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. Overall, the proposed rule change is intended to align the Exchange's sponsored access rules in Supplementary Material to Rule 706 with the Nasdaq Sponsored Access Rules, and is part of the Exchange's continued effort to promote efficiency and conformity of its processes with those of the Nasdaq Exchanges. Consistent rules and processes across the Affiliated Exchanges would in turn simplify the regulatory requirements for members of the Exchange that are also participants on the Nasdaq Exchanges. The Exchange believes that its proposal would provide greater harmonization among similar rules and procedures of the Affiliated Exchanges, resulting in greater uniformity and more efficient regulatory compliance. As such, the proposed rule change would foster cooperation and coordination with persons engaged in facilitating transactions in securities and would remove impediments to and perfect the mechanism of a free and open market and national market system.

#### Defining Sponsored Access

Adding a definition of Sponsored Access will assist market participants to understand the type of arrangements that are subject to Supplementary Material to Rule 706, and such clarity will serve to promote just and equitable principles of trade. The Exchange believes that adding the Sponsored Access definition will provide its members with additional guidance with respect to this Rule.

#### Defining Customer Agreement

Defining the agreement that Sponsored Customers must enter into and maintain with one or more Sponsoring Members to establish proper relationship(s) and account(s) through which the Sponsored Customer may trade on the Exchange, as a "Customer Agreement" will also serve to provide members with clarity on the agreement that the Exchange will continue to require and the obligations that are contained within the Customer Agreement. This amendment is non-substantive.

#### Market Access Rule

As discussed above, Exchange members will continue to be required to comply with Supplementary Material to Rule 706 and the Market Access Rule. The Exchange believes that specifically enumerating the member's responsibility to comply with the Market Access Rule within the Rule itself will provide members with additional guidance concerning the application of the Rule. This change is non-substantive as members are currently responsible for complying with the Market Access Rule.

#### Elimination of Certain Contract Requirements

Removing the requirements to submit and complete a Sponsored Customer Agreement and Addendum will remove impediments to and perfect the mechanism of a free and open market by aligning the Exchange's sponsored access rules with the Nasdaq Sponsored Access Rules, which currently do not require additional agreements for their sponsored participants other than a Customer Agreement.<sup>23</sup> The Exchange believes that its proposal would create equivalent sponsored access standards and requirements among the Affiliated Exchanges and also provide clarity to its members, which is beneficial to both investors and the public interest. While elimination of the Sponsored Customer Agreement requirement will also eliminate the Exchange's contractual privity with the Sponsored Customer, the Exchange notes that any potential concerns to the loss of privity are mitigated by the Exchange's ability to restrict the Sponsored Customer's access to a port at any time it is warranted by the Sponsored Customer's trading activity. As discussed above, connectivity to the Exchange must be requested by a member of the Exchange. Such connection requires approval by the Exchange, testing and other security features as well as information sharing with the Exchange by the member. In addition, Supplementary Material .01(b)(2) to Rule 706 delineates the terms of the required contractual relationship between the Sponsoring Member and the Sponsored Customer in the Customer Agreement, which remains in effect. The Exchange also believes that the Addendum is unnecessary in light of the fact that Sponsoring Members must request connectivity to the Exchange as well as enter into a Customer Agreement with the Sponsored Customer. Furthermore, as discussed above, the Exchange will

<sup>20</sup> See Rule 706, Supplementary Material .01(b)(vii).

<sup>21</sup> 15 U.S.C. 78f(b).

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> See NQX Rule 4615, BX Rule 4615 and PHILX Rule 1094.

require members to disclose the Sponsored Customer relationship as a condition to approving the member's port request to provide Sponsored Access. Finally, as is the case with other Exchange rules, the Exchange examines for compliance with Supplementary Material to Rule 706 and may request information about any customer relationship which concerns the Exchange pursuant to Rule 1601.

#### Clean-Up Changes

The Exchange believes that the proposed changes to correct the two typos in subsections (vii) and (ix) of Supplementary Material .01(b)(2) to Rule 706 will add further clarification to the Exchange's Rulebook and alleviate potential confusion as to the applicability of the Exchange's rules, which will protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act because all members would be subject to the same sponsored access requirements, as discussed above. The proposed rule change is designed to provide greater harmonization among the sponsored access rules across the Affiliated Exchanges, resulting in more efficient regulatory compliance for common members, and is not intended to have any competitive effect.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>24</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>25</sup>

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act<sup>26</sup> normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)(iii)<sup>27</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Exchange represents that waiver of the operative delay would allow the Exchange to harmonize its sponsored access rule to the rules of the Nasdaq Exchanges.<sup>28</sup> The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the proposed rule change would simplify the regulatory requirements of members of the Exchange that are also participants on the Nasdaq Exchanges. Further, the Commission does not believe that the proposed rule change raises any new or novel issues. Accordingly, the Commission hereby waives the operative delay and designates the proposal operative upon filing.<sup>29</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is: (i) Necessary or appropriate in the public interest; (ii) for the protection of investors; or (iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

<sup>26</sup> 17 CFR 240.19b-4(f)(6).

<sup>27</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>28</sup> See *supra* note 3.

<sup>29</sup> For purposes only of waiving the 30-day operative delay, the Commission has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2018-44 on the subject line.

#### Paper Comments

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

All submissions should refer to File Number SR-ISE-2018-44. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2018-44 and should be submitted on or before June 11, 2018.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>30</sup>

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<sup>24</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>25</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days

<sup>30</sup> 17 CFR 200.30-3(a)(12).