

March 16, 2015

Brent J. Fields  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-0609

Re: File No. SR-PHLX-2013-113

Dear Mr. Fields:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to provide additional comment on the above-referenced proposed rule change.<sup>1</sup> The proposal would introduce an unprecedented customer rebate on NASDAQ OMX PHLX, LLC ("Phlx") based, in part, on volume executed on affiliated markets.<sup>2</sup> After several rounds of notice and comment, the Commission disapproved the proposed rule change, with the staff of the Division of Trading and Markets acting pursuant to authority delegated by the Commission.<sup>3</sup> Phlx then petitioned the Commission to reconsider that disapproval. ISE urges the Commission to affirm the initial disapproval. We believe that the proposed cross-exchange rebates are unfairly discriminatory and anti-competitive.

As the Commission rightly concluded in disapproving the proposed rule change, precedent from the ArcaBook Order<sup>4</sup> requires that exchange fee filings be addressed at the level of the individual exchange. This is abundantly clear from the text of the ArcaBook Order, which states that compliance with the relevant statutory standards for exchange rules is "applied at the level of the individual registered securities exchange, not at the group level of exchanges that are under common control."<sup>5</sup> In contrast, Phlx repeatedly argues that the "unambiguous" terms of the Exchange Act conflict with that decision. The only statutory support Phlx provides in favor of this proposition is the general obligation that the Commission has to ensure that exchange rules protect investors and promote efficiency, competition, and capital formation. This statutory citation does not support Phlx's conclusory argument, and, in fact,

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<sup>1</sup> This letter supplements comments already filed by ISE on the proposed rule change. See Letters dated November 11, 2013, December 20, 2013, and May 20, 2014 from Michael Simon, Secretary and General Counsel, ISE, to Elizabeth Murphy, Secretary, Commission.

<sup>2</sup> See Securities Exchange Act Release No. 70866 (November 13, 2013), 78 FR 69472 (November 19, 2013) ("Proposing Release").

<sup>3</sup> See Securities Exchange Act Release No. 72633 (July 16, 2014), 79 FR 42578 (July 22, 2014) (SR-Phlx-2013-113) ("Disapproval Order").

<sup>4</sup> See Securities Exchange Act Release No. 59039 (December 2, 2008), 73 FR 74770 (December 9, 2008) ("ArcaBook Order").

<sup>5</sup> *Id.* at 74793.

provides strong support against it. It is precisely in the interest of protecting investors and promoting competition that the Commission must continue to evaluate proposed exchange fee changes at the individual exchange level.

As we noted in our previous letters, one of the primary ways that exchanges compete with each other is through the fees that we charge. Allowing exchanges to bundle fees by having volume executed on one market to count towards rebates on another market will weaken this competition. Indeed, the Commission was expressly concerned with this sort of anti-competitive effect in the ArcaBook Order when it determined that exchange filings should be reviewed at the level of the individual securities exchange. We believe the Commission's reasoned assessment in the ArcaBook Order is consistent with the statutory requirements and should be upheld.

Applying the relevant standard discussed above, the proposed fee change would unfairly discriminate against Phlx members that do not trade on its affiliated options exchanges. As detailed in the Disapproval Order, the proposed rule change would treat similarly situated members differently based on whether they are also active members of a Phlx affiliate.<sup>6</sup> Specifically, members that have identical volume on Phlx would be treated differently if one qualifies for the rebate based on additional volume executed on an affiliated market. It is no consolation that members can apply to become members of Phlx's affiliates, as doing so may not fit the member's business needs and would require that the member incur significant one-time and continuing costs, including for regulatory, membership, and connectivity fees. Requiring members to absorb such costs to be eligible for a rebate is not reasonable or equitable.

Phlx stresses that members can still execute the required volume on their market without trading on an affiliated exchange. However, this argument misses the point entirely. Regardless of whether it is *possible* to execute the volume on Phlx alone, members are unfairly disadvantaged relative to their similarly situated peers if they do not trade on the other markets. In fact, this discrimination is an integral part of the proposal, which seeks to encourage members to trade not just on Phlx but also on the other affiliated markets.

The disapproved fee change would also place an undue burden on competition. Competition between markets is a bedrock principle of our national market system. By allowing markets under the same corporate umbrella to act in concert when setting fees, the Phlx proposal would erode this central principle to the detriment of investors and the markets in general. It would also place an undue burden on exchanges that only operate one market and are therefore unable to adopt similar bundled pricing arrangements. While there are benefits to running multiple markets within an exchange group, there are also significant costs, including time and financial resources. Although ISE has recently launched a second market, we do not believe that an exchange that wishes to

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<sup>6</sup> See Disapproval Order, *supra* note 3 at 42586.

compete on equal footing with its competitors should be *required* to register multiple affiliated exchanges.

Finally, as support for its petition, Phlx cites two rule changes filed by other exchanges that it apparently believes conflict with the decision to disapprove its proposed fee change. Like other attempted comparisons already addressed by ISE in prior comment letters,<sup>7</sup> both of the new filings selected by Phlx for comparison are irrelevant to the current situation.

- First, Phlx attempts to compare its disapproved fee change to a recent proposed rule change that established a market data feed containing consolidated data derived from exchanges operated by BATS Global Markets, Inc. (“BATS”). As opposed to the Phlx proposal, the BATS filings involve the creation of a consolidated market data product that would compete on equal footing with similar products already marketed and offered by market data vendors. Importantly, unlike with the Phlx proposal, the BATS filings are not designed to attract order flow to affiliated exchanges, and market participants do not need to be active members of *any* of the BATS markets in order to benefit from the consolidated market data product. This comparison is therefore inapposite.
- Second, Phlx attempts to compare its disapproved fee change to a Chicago Board Options Exchange, Inc. (“CBOE”) volume-based fee discount in proprietary options classes. The CBOE proprietary products sliding scale, which establishes tiered fees for members of a single exchange, is not a cross-exchange fee. Moreover, differential fees for different products and market participants within a single exchange have always been an accepted part of the regulatory landscape. This is true for fees on Phlx as well. ISE is frankly at a loss as to what, if any, connection this CBOE filing has to Phlx’s disapproved cross-exchange fees. Indeed, ISE believes that Phlx reaching this far to find support for its filing further proves how unprecedented the proposed fees are.<sup>8</sup>

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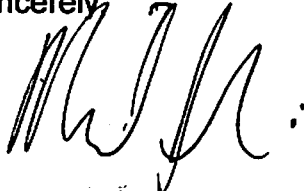
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<sup>7</sup> See supra note 1.

<sup>8</sup> Phlx also raises one procedural objection to the Disapproval Order, arguing that because the disapproval resulted from the Commission acting pursuant to authority the Commission delegated to the Director of the Division of Trading and Markets (“Director”), the Commission itself did not act within the required statutory timeframe required for Commission action. That argument is legally incorrect. Pursuant to Section 200.30-3 of the Commission’s Rules of Procedure, action the Director takes pursuant to delegated is final action by the Commission, subject to review upon petition by a party aggrieved by such action pursuant to Section 201.430 of such rules. To hold otherwise not only would be contrary to law, but also would result in virtually all Commission approvals of self-regulatory rule filings being invalid since in almost all such cases Commission approval of rules filings is accomplished through delegated authority.

For the reasons stated above, and in the interest of maintaining a fair and competitive market, ISE believes that the Commission should uphold the decision to disapprove the proposed cross-exchange fee change. We thank the Commission for the opportunity to comment on this proposed fee change. If you have any additional questions, or if we can be of further assistance in this matter, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink, appearing to read "MJS:", is positioned below the word "Sincerely,".

**Michael J. Simon,  
Secretary and General Counsel**