

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-59134; File No. 4-574)

December 22, 2008

Program for Allocation of Regulatory Responsibilities Pursuant to Rule 17d-2; Order Approving and Declaring Effective a Plan for the Allocation of Regulatory Responsibilities Between the International Securities Exchange, LLC and the Financial Industry Regulatory Authority, Inc.

Notice is hereby given that the Securities and Exchange Commission (“Commission”) has issued an Order, pursuant to Sections 17(d)<sup>1</sup> and 11A(a)(3)(B)<sup>2</sup> of the Securities Exchange Act of 1934 (“Act”), approving and declaring effective a plan for the allocation of regulatory responsibilities (“Plan”) that was filed pursuant to Rule 17d-2 under the Act<sup>3</sup> by the International Securities Exchange, LLC (“ISE”) and the Financial Industry Regulatory Authority, Inc. (“FINRA”) (together with ISE, the “Parties”).<sup>4</sup>

Accordingly, FINRA shall assume, in addition to the regulatory responsibility it has under the Act, the regulatory responsibilities allocated to it under the Plan. At the same time, ISE is relieved of those regulatory responsibilities allocated to FINRA under the Plan.

I. Introduction

Section 19(g)(1) of the Act,<sup>5</sup> among other things, requires every self-regulatory organization (“SRO”) registered as either a national securities exchange or registered securities association to examine for, and 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, unless

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<sup>1</sup> 15 U.S.C. 78q(d).

<sup>2</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>3</sup> 17 CFR 240.17d-2.

<sup>4</sup> See Securities Exchange Act Release No. 59003 (November 24, 2008), 73 FR 72873 (December 1, 2008) (“Notice”).

<sup>5</sup> 15 U.S.C. 78s(g)(1).

the SRO is relieved of this responsibility pursuant to Section 17(d)<sup>6</sup> or 19(g)(2)<sup>7</sup> of the Act. Section 17(d)(1) of the Act<sup>8</sup> was intended, in part, to eliminate unnecessary multiple examinations and regulatory duplication for those broker-dealers that maintain memberships in more than one SRO (“common members”).<sup>9</sup> With respect to a common member, Section 17(d)(1) authorizes the Commission, by rule or order, to relieve an SRO of the responsibility to receive regulatory reports, to examine for and enforce compliance with applicable statutes, rules, and regulations, or to perform other specified regulatory functions.

To implement Section 17(d)(1), the Commission adopted two rules: Rule 17d-1<sup>10</sup> and Rule 17d-2<sup>11</sup> under the Act. Rule 17d-2 permits SROs to propose joint plans for the allocation of regulatory responsibilities, other than financial responsibility rules, with respect to their common members. Under paragraph (c) of Rule 17d-2, the Commission may declare such a plan effective if, after providing for notice and comment, it determines that the plan is necessary or appropriate in the public interest and for the protection of investors, to foster cooperation and coordination among the SROs, to remove impediments to, and foster the development of, a national market system and a national clearance and settlement system, and is in conformity with the factors set forth in Section 17(d) of the Act. Upon effectiveness of a plan filed pursuant to Rule 17d-2, an

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<sup>6</sup> 15 U.S.C. 78q(d).

<sup>7</sup> 15 U.S.C. 78s(g)(2).

<sup>8</sup> 15 U.S.C. 78q(d)(1).

<sup>9</sup> See Securities Act Amendments of 1975, Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 249, S. Rep. No. 94-75, 94th Cong., 1st Session 32 (1975).

<sup>10</sup> 17 CFR 240.17d-1. Rule 17d-1 authorizes the Commission to name a single SRO as the designated examining authority (“DEA”) to examine common members for compliance with the financial responsibility requirements imposed by the Act, or by Commission or SRO rules.

<sup>11</sup> 17 CFR 240.17d-2.

SRO is relieved of those regulatory responsibilities for common members that are allocated by the plan to another SRO.

On December 1, 2008, the Commission published notice of the Plan filed by ISE and FINRA.<sup>12</sup> The Commission received no comments on the Plan. The Plan is separate from the agreement made pursuant to Rule 17d-2 between ISE and FINRA entered into on December 20, 2006 (the “Foundation Plan”).<sup>13</sup> This Plan supplements the Foundation Plan by delineating regulatory responsibilities between the Parties, including responsibility for ISE rules, with respect to Direct Edge ECN, LLC (“DE ECN”), which is a common member of FINRA and ISE, and which also is affiliated with ISE.<sup>14</sup>

The text of the Plan allocates regulatory responsibilities among the Parties with respect to DE ECN, which is a common member. Included in the Plan is an attachment (the “ISE Certification of Common Rules,” referred to herein as the “Certification”) that lists every ISE

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<sup>12</sup> See Notice, *supra* note 4.

<sup>13</sup> See Securities Exchange Act Release No. 55367 (February 27, 2007), 72 FR 9983 (March 6, 2007). Pursuant to the Foundation Plan, FINRA has assumed certain inspection, examination, and enforcement responsibility for common members, including ISE Route LLC, the outbound Router Member, with respect to certain applicable laws, rules, and regulations.

<sup>14</sup> On November 17, 2008, the Commission published notice of a proposed rule change by the ISE relating to the proposed acquisition by ISE Holdings, Inc., the parent of ISE, of an equity interest in Direct Edge Holdings LLC (“Direct Edge”) in exchange for cash and the ISE’s equities trading facility, ISE Stock Exchange, LLC (“ISE Stock”). After such transaction, (1) Direct Edge, through a subsidiary, will own and operate ISE Stock as a facility of ISE and (2) ISE Holdings will have a 31.54% equity interest in Direct Edge, which wholly owns and operates an Electronic Access Member of ISE, DE ECN. Recognizing the potential for conflicts of interest in instances where an exchange is affiliated with one of its members, ISE proposed ISE Rule 312(b), which imposes several conditions and limitations to the affiliation between ISE and DE ECN, one of which is that ISE enter into a 17d-2 plan with a non-affiliated self-regulatory organization to regulate and oversee the activities of DE ECN. The Plan is intended to satisfy this condition. See Securities Exchange Act Release No. 58918 (November 7, 2008), 73 FR 67909 (November 17, 2008).

rule and federal securities law and rule and regulation thereunder for which, under the Plan, FINRA would bear responsibility for examining, and enforcing compliance by, DE ECN.

## II. Discussion

The Commission finds that the proposed Plan is consistent with the factors set forth in Section 17(d) of the Act<sup>15</sup> and Rule 17d-2(c) thereunder<sup>16</sup> in that the proposed Plan is necessary or appropriate in the public interest and for the protection of investors, fosters cooperation and coordination among SROs, and removes impediments to and fosters the development of the national market system. In particular, the Commission believes that the proposed Plan should reduce unnecessary regulatory duplication by allocating to FINRA certain responsibilities for DE ECN, a common member, that would otherwise be performed by both ISE and FINRA. Accordingly, the proposed Plan promotes efficiency by reducing costs to DE ECN. Furthermore, because ISE and FINRA will coordinate their regulatory functions in accordance with the Plan, the Plan should promote investor protection.

The Commission notes that, under the Plan, ISE and FINRA have allocated regulatory responsibility for all ISE rules that are substantially similar to FINRA rules in that ISE's rule would not require FINRA to develop one or more new examination standards, modules, procedures, or criteria in order to analyze the application of the rule, or a dual member's activity, conduct, or output in relation to such rule ("Common Rules"). These Common Rules are specifically listed in the Certification. In addition, under the Plan, FINRA would assume

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<sup>15</sup> 15 U.S.C. 78q(d).

<sup>16</sup> 17 CFR 240.17d-2(c).

regulatory responsibility for any provisions of the federal securities laws and the rules and regulations thereunder that are set forth in the Certification.<sup>17</sup>

The Plan further provides that FINRA shall not assume regulatory responsibility, and ISE will retain full responsibility, for: (1) surveillance, examination, investigation, and enforcement with respect to trading activities or practices involving ISE's own marketplace; (2) registration pursuant to ISE's applicable rules of associated persons (i.e., registration rules that are not Common Rules); (3) ISE's duties as a DEA under Rule 17d-1 of the Act;<sup>18</sup> and (4) any rules of ISE that do not qualify as Common Rules, except that FINRA shall be responsible for such rules with respect to any ISE member that operates as a facility,<sup>19</sup> acts as an inbound router for ISE, and is a member of ISE and FINRA ("Inbound Router Member").<sup>20</sup> Apparent violations of any ISE rules by the Inbound Router Member will be processed by FINRA, and FINRA will conduct any enforcement proceedings. The effect of these provisions is that regulatory oversight and enforcement responsibilities for the Inbound Router Member will be vested with FINRA. These provisions should help avoid any potential conflicts of interest that could arise if ISE was primarily responsible for regulating the Inbound Router Member, with which ISE is affiliated.<sup>21</sup>

According to the Plan, ISE will perform a review of the Certification, at least annually, or more frequently if required by changes in either the rules of ISE or FINRA, to add ISE rules not included on the then-current list of Common Rules that are substantially similar to FINRA rules

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<sup>17</sup> As proposed currently, however, there are no federal securities rules listed on the Certification. Therefore, at present, ISE has not been relieved of any regulatory responsibilities, pursuant to the Plan, for any provisions of the federal securities laws and the rules and regulations thereunder.

<sup>18</sup> 17 CFR 240.17d-1.

<sup>19</sup> See Section 3(a)(2) of the Act (defining "facility"). 15 USC 78c(a)(2).

<sup>20</sup> Currently, DE ECN is the only Inbound Router Member.

<sup>21</sup> See supra note 14.

(i.e., new rules that qualify as Common Rules or existing rules that have been amended so that they now qualify as Common Rules); delete ISE rules included in the then-current list of Common Rules that are no longer substantially similar to FINRA rules (i.e., amended rules that cease to be Common Rules); and confirm that the remaining rules on the list of Common Rules continue to be ISE rules that are substantially similar to FINRA rules. FINRA will then confirm in writing whether the rules listed in any updated list are Common Rules as defined in the Plan.

The Commission is hereby declaring effective and approving a plan that, among other things, allocates regulatory responsibility to FINRA for the oversight and enforcement of all ISE rules that are substantially similar to the rules of FINRA for DE ECN, a common member of ISE and FINRA. Therefore, modifications to the Certification need not be filed with the Commission as an amendment to the Plan, provided that the Parties are only adding to, deleting from, or confirming changes to ISE rules in the Certification in conformance with the definition of Common Rules provided in the Plan. However, should ISE or FINRA decide to add an ISE rule to the Certification that is not substantially similar to an FINRA rule; delete an ISE rule from the Certification that is substantially similar to an FINRA rule; or leave on the Certification an ISE rule that is no longer substantially similar to an FINRA rule, then such a change would constitute an amendment to the Plan, which must be filed with the Commission pursuant to Rule 17d-2 under the Act.<sup>22</sup>

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<sup>22</sup> The Commission also notes that the addition to (or eventual deletion from) the Certification of any federal securities laws, rules, and regulations for which FINRA would bear responsibility under the Plan for examining, and enforcing compliance by, common members, would constitute an amendment to the Plan.

The Plan also permits ISE and FINRA to terminate the Plan, subject to notice, for various reasons.<sup>23</sup>

### III. Conclusion

This Order gives effect to the Plan filed with the Commission in File No. 4-574. The Parties shall notify all members affected by the Plan of their rights and obligations under the Plan.

IT IS THEREFORE ORDERED, pursuant to Sections 17(d) of the Act, that the Plan in File No. 4-574, between ISE and FINRA, filed pursuant to Rule 17d-2 under the Act, is approved and declared effective.

IT IS THEREFORE ORDERED that ISE is relieved of those responsibilities allocated to FINRA under the Plan in File No. 4-574.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

Florence E. Harmon  
Acting Secretary

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<sup>23</sup> The Commission notes that paragraph 12 of the Plan reflects the fact that FINRA's responsibilities under the Plan will continue in effect until the earlier of (a) the date on which DE ECN ceases operations as a facility of ISE, or (b) the Commission approves the termination of the Plan.

<sup>24</sup> 17 CFR 200.30-3(a)(34).