

underwriters (or their affiliates) at a rate higher than that which they had received from the Existing Portfolios, their advisors or underwriters (or their affiliates), including without limitation 12b–1 Fees, shareholder service, administration or other service fees, revenue sharing or other arrangements in connection with such assets. Applicants represent that the Substitution and the selection of the Replacement Portfolios were not motivated by any financial consideration paid or to be paid by the Replacement Portfolios, their advisors or underwriters, or their respective affiliates.

14. Notice of the proposed Substitution will be mailed to all Contract owners at least 30 days prior to the Substitution. All Contract owners will have an opportunity at anytime after receipt of the notice of the Substitution and for 30 days after the Substitution to transfer Contract account value affected by the Substitution to other available subaccounts without the imposition of any transfer charge or limitation and without being counted as one of the Contract owner's free transfers in a contract year.

15. Within five days after the Substitution, the Integrity Companies will send to its affected Contract owners a written confirmation that the Substitution has occurred.

16. The Substitution will in no way alter the insurance benefits to Contract owners or the contractual obligations of the Integrity Companies.

17. The Substitution will have no adverse tax consequences to Contract owners and will in no way alter the tax benefits to Contract owners.

## Conclusion

For the reasons and upon the facts set forth above, the Applicants believe that the requested order meets the standards set forth in Section 26(c) and should, therefore, be granted.

For the Commission, by the Division of Investment Management, under delegated authority.

**Florence E. Harmon,**  
*Deputy Secretary.*

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**BILLING CODE 8011–01–P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–61698; File Nos. 10–194 and 10–196<sup>1</sup>]

### In the Matter of the Applications of EDGX Exchange, Inc., and EDGA Exchange, Inc. for Registration as National Securities Exchanges; Findings, Opinion, and Order of the Commission

March 12, 2010.

#### I. Introduction

On May 7, 2009, EDGX Exchange, Inc. (“EDGX”) and EDGA Exchange, Inc. (“EDGA”) (each, an “Exchange,” and, together, the “Exchanges”) each submitted to the Securities and Exchange Commission (“Commission”) a Form 1 application (each, a “Form 1 Application,” and, together, the “Form 1 Applications”) under the Securities Exchange Act of 1934 (“Act”) seeking registration as a national securities exchange pursuant to Section 6 of the Act.<sup>2</sup> On July 30, 2009, each Exchange submitted Amendment No. 1 to its Form 1 Application. Notice of the Form 1 Applications, each as modified by Amendment No. 1, was published for comment in the **Federal Register** on September 17, 2009.<sup>3</sup> The Commission received two comment letters regarding the Form 1 Applications, as modified by Amendment No. 1.<sup>4</sup> On February 11, 2010, each Exchange submitted Amendment No. 2 to its Form 1 Application.<sup>5</sup>

<sup>1</sup> In the Notice (as defined below), EDGA Exchange, Inc. was assigned File No. 10–194 and EDGX Exchange, Inc. was assigned File No. 10–193. The EDGX Exchange, Inc. file number was subsequently redesignated as File No. 10–196. The EDGA Exchange, Inc. file number remains unchanged.

<sup>2</sup> 15 U.S.C. 78f. On September 11, 2009, the Commission issued an order granting EDGX and EDGA exemptive relief, subject to certain conditions, in connection with filing of their Form 1 applications. See Securities Exchange Act Release No. 60650 (September 11, 2009), 74 FR 47828.

<sup>3</sup> See Securities Exchange Act Release No. 60651 (September 11, 2009), 74 FR 47827 (“Notice”).

<sup>4</sup> See letters to Elizabeth M. Murphy, Secretary, Commission, from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq OMX Group, Inc., dated November 11, 2009 (“Nasdaq Letter”) and from Daniel Mathisson, Managing Director, and Vaishali Javeri, Director and Counsel, Credit Suisse Securities (USA) LLC, dated December 4, 2009 (“Credit Suisse Letter”). Direct Edge Holdings LLC responded to the Nasdaq Letter. See letter from William O’Brien, Chief Executive Officer, Direct Edge Holdings LLC, to Elizabeth M. Murphy, Secretary, Commission, dated November 13, 2009 (“DE Holdings Response”).

<sup>5</sup> In Amendment No. 2, each Exchange modified several Exhibits in its Form 1 Application. Specifically, each Exchange’s Amendment No. 2:

(a) Modifies Exhibit B to: (A) Specify the dates when the non-U.S. Upstream Owners adopted the Supplemental Resolutions (as defined below); and

## II. Statutory Standards

Under sections 6(b) and 19(a) of the Act,<sup>6</sup> the Commission shall by order grant a registration as a national securities exchange if it finds, among

(B) revise the proposed rules of each Exchange to: (i) Indicate in Rules 1.5(p), 11.9(a), 14.2(g), 14.3(d) that the Post-Closing Session ends at 8 p.m.; (ii) add Rule 2.3(b)–(f) (Member Eligibility & Registration) to require registration of Authorized Traders and Principals in the appropriate category of registration as determined by the Exchange, and make conforming amendments to the interpretations and policies for Rule 2.5; (iii) reflect Direct Edge ECN LLC’s assumed name of DE Route in Rules 2.11 and 2.12, regarding its roles as an inbound and outbound router; (iv) add Rule 3.21 (Customer Disclosures) to require Exchange members that execute trades on behalf of customers during either Pre-Opening or Post-Closing Sessions offered by the Exchange to provide customers with notice regarding the risks of trading during extended hours, consistent with the rules of other self-regulatory organizations; (v) amend Rule 11.5(a) to clarify that market orders are not eligible for the Pre-Opening and Post-Closing Sessions; (vi) add new Interpretation and Policy .01 to Rule 14.1 to explain the circumstances under which the Exchange will halt trading during the Pre-Opening and Post-Closing Sessions; (vii) amend Rule 11.11 to enable DTC/NSCC authorized clearing brokers to clear trades on the Exchange, even though they are not Exchange members; (viii) add section (d) to Rule 11.12 (Limitation of Liability) to establish a procedure to compensate Exchange members in relation to Exchange systems failures or a negligent act or omission of an Exchange employee, consistent with industry practice; (ix) revise the Exchange’s Clearly Erroneous Trading rules (Rule 11.13) to comport with those filed by other registered national securities exchanges; and (x) add Rule 12.13 (Trading Ahead of Research Reports).

(b) Revises Exhibit C to clarify, in the description of Direct Edge ECN LLC, the cessation of its capacity as an electronic communications network following the Exchanges’ commencement of operations as national securities exchanges.

(c) Modifies Exhibit E to: (A) Provide a clarification with respect to the Exchange’s membership in various order and trade reporting organizations; (B) refer to the planned phase-in of securities to be traded on the Exchange; and (C) update a reference to the provision of technical systems specifications and the addition of a copy of the Direct Edge Next Gen FIX Specifications (Version 1.0) (Users Manual).

(d) Revises Exhibit F to amend the Clearing Letter of Guarantee, User Agreement, Routing Agreement, and Exchange Data Vendor Agreement to reflect comments by potential Exchange members and industry practice.

(e) Modifies Exhibit I to state that, prior to the launch of the Exchange, DE Holdings will make a capital contribution into the Exchange’s capital account, and to represent that DE Holdings will enter into an explicit agreement with the Exchange to provide adequate funding for its operations.

(f) Amends Exhibit J to state that all Directors, including Owner Directors and the Chief Executive Officer, will serve staggered three-year terms, subject to the Exchange’s Bylaws.

(g) Revises to Exhibit L to describe the Exchange’s execution of a regulatory services agreement with the ISE LLC and the Financial Industry Regulatory Authority (“FINRA”) to conduct various regulatory services on behalf of the Exchange.

The changes proposed in Amendment No. 2 are either not material, consistent with the existing rules of other registered national securities exchanges, or responsive to the concerns of the Commission.

<sup>6</sup> 15 U.S.C. 78f(b) and 78s(a).

other things, that the exchange is so organized and has the capacity to carry out the purposes of the Act and can comply, and can 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 that the Exchanges' Form 1 Applications for exchange registration meet the requirements of the Act and the rules and regulations thereunder. Further, the Commission finds that the proposed rules of the Exchanges are consistent with Section 6 of the Act in that, among other things, they are designed to: (1) Assure fair representation of an exchange's members in the selection of its directors and administration of its affairs and provide that, among other things, one or more directors shall be representative of investors and not be associated with the exchange, or with a broker or dealer; (2) 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, remove impediments to and perfect the mechanisms of a free and open market and a national market system; and (3) protect investors and the public interest. The Commission also believes that the rules of the Exchanges are consistent with section 11A of the Act.<sup>7</sup> Finally, the Commission finds that the proposed rules of the Exchanges do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.<sup>8</sup>

### III. Discussion

#### A. Corporate Structure

EDGX and EDGA each have applied to the Commission to register as a national securities exchange. EDGX and EDGA currently operate as separate trading platforms of Direct Edge ECN LLC ("DECN"), an electronic communications network ("ECN") that is a registered broker-dealer. Direct Edge Holdings LLC ("DE Holdings"), a Delaware limited liability company, wholly owns EDGX, EDGA, and DECN. Following EDGX's and EDGA's commencement of operations as national securities exchanges, DECN will cease operations as an ECN and DECN (doing business as DE Route) will

begin to operate as a facility of the Exchanges that provides outbound order routing for the Exchanges. DECN also will provide inbound routing services to EDGX from EDGA, and to EDGA from EDGX.<sup>9</sup>

As a limited liability company, DE Holdings is overseen by a Board of Managers ("DE Holdings Board") and ownership in DE Holdings is represented by limited liability membership interests. The Fourth Amended and Restated Limited Liability Company Operating Agreement of DE Holdings ("DE Holdings Operating Agreement") refers to the holders of such interests as "Members."<sup>10</sup> The Members of DE Holdings and their respective ownership interests are: International Securities Exchange Holdings, Inc. ("ISE Holdings") (31.54%);<sup>11</sup> Citadel Derivatives Group LLC (19.9%); The Goldman Sachs Group, Inc. (19.9%); Knight/Trimark, Inc. (19.9%); and the ISE Stock Exchange Consortium Members (collectively 8.76%).<sup>12</sup>

#### 1. Ownership of ISE Holdings

ISE Holdings, the owner of a 31.54% equity interest in DE Holdings, is also the parent company of International Securities Exchange, LLC ("ISE LLC"), a national securities exchange registered under section 6 of the Exchange Act. Following a corporate transaction in 2007 (the "2007 Transaction"),<sup>13</sup> ISE Holdings became a wholly-owned subsidiary of U.S. Exchange Holdings, Inc. ("U.S. Exchange Holdings"), which is wholly owned by Eurex Frankfurt AG ("Eurex Frankfurt," and, with Deutsche Börse AG, the "German Upstream

Owners"). Eurex Frankfurt is a wholly-owned subsidiary of Eurex Zürich AG ("Eurex Zürich"), which, in turn, is jointly owned by Deutsche Börse AG and SIX Swiss Exchange AG ("SWX"), a wholly-owned subsidiary of SIX Group AG (SIX Group AG, SWX, and Eurex Zürich are referred to collectively as the "Swiss Upstream Owners," and the Swiss Upstream Owners and the German Upstream Owners are referred to collectively as the "non-U.S. Upstream Owners"). As a result of ISE Holdings' purchase of an equity interest in DE Holdings,<sup>14</sup> the non-U.S. Upstream Owners, U.S. Exchange Holdings (together with the non-U.S. Upstream Owners, the "Upstream Owners"), and ISE Holdings acquired indirect ownership and voting interests in EDGX and EDGA.

#### 2. Amendments to the Corporate Resolutions of the Non-U.S. Upstream Owners and Corporate Governing Documents of ISE Holdings and U.S. Exchange Holdings

In connection with the 2007 Transaction, each of the non-U.S. Upstream Owners adopted corporate resolutions (collectively, the "2007 Resolutions") designed to maintain the independence of the regulatory functions of ISE LLC.<sup>15</sup> In addition, the Amended and Restated Certificate of Incorporation of U.S. Exchange Holdings ("U.S. Exchange Holdings Certificate") and the Amended and Restated Bylaws of U.S. Exchange Holdings ("U.S. Exchange Holdings Bylaws"), as well as the Certificate of Incorporation of ISE Holdings ("ISE Holdings Certificate") and the Amended and Restated Bylaws of ISE Holdings ("ISE Holdings Bylaws") included provisions designed to maintain the independence of the regulatory functions of ISE LLC.<sup>16</sup>

<sup>14</sup> See DE Holdings Order, *supra* note 11.

<sup>15</sup> See Eurex Order, *supra* note 13. In 2007, the non-U.S. Upstream Owners were Eurex Frankfurt, Deutsche Börse AG, Eurex Zürich, SWX, SWX Group, and Verein SWX Swiss Exchange.

<sup>16</sup> In this regard, through the 2007 Resolutions and the corporate governing documents of ISE Holdings and U.S. Exchange Holdings, the Upstream Owners and ISE Holdings committed, among other things: That they, and each of their directors, officers, and employees, would comply with the federal securities laws and with the Commission and ISE LLC; that their directors, officers, and employees would give due regard to preserving the independence of the self-regulatory functions of ISE LLC (or in the case of the non-U.S. Upstream Owners, that they would take reasonable steps necessary to cause their officers and employees involved in the activities of ISE LLC to give due regard to preserving the independence of the self-regulatory functions of ISE LLC); that their books and records related to the activities of ISE LLC would be subject at all times to inspection and copying by the Commission and ISE LLC, and

<sup>9</sup> See EDGX and EDGA Rules 2.11 and 2.12. See also Section III.G, *infra*.

<sup>10</sup> Specifically, the DE Holdings Operating Agreement defines a "Member" to include any Person (i) executing the DE Holdings Operating Agreement as a Member of DE Holdings as of April 13, 2009; or (ii) subsequently admitted as an additional or substitute Member of DE Holdings. References to "Members," as defined in the DE Holdings Operating Agreement and used in connection with DE Holdings, should be distinguished from references to "members," the latter refers to "members" as defined in section 3(a)(3) of the Exchange Act, 15 U.S.C. 78c(a)(3).

<sup>11</sup> See Securities Exchange Act Release No. 59135 (December 22, 2008), 73 FR 79954 (December 30, 2008) (File No. SR-ISE-2008-85) (order relating to ISE Holdings' purchase of an ownership interest in DE Holdings) ("DE Holdings Order").

<sup>12</sup> The ISE Stock Exchange Consortium members are: Bear Rex, Inc.; DB US Financial Markets Holding Corporation; Canopy Acquisition Corporation; IB Exchange Corp.; LabMorgan Corporation; Merrill Lynch L.P. Holdings, Inc.; Nomura Securities International, Inc.; Sun Partners LLC; and VCM Capital Markets, LLC.

<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 relating to the 2007 Transaction) ("Eurex Order").

<sup>7</sup> 15 U.S.C. 78k-1.

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

The 2007 Resolutions and the corporate governing documents of U.S. Exchange Holdings and ISE Holdings related to ISE LLC and, by their terms, did not apply to additional national securities exchanges, such as EDGX and EDGA, that the Upstream Owners and ISE Holdings might control, directly or indirectly, as a result of a subsequent transaction. To maintain the independence of the regulatory function of EDGX and EDGA, each of the non-U.S. Upstream Owners has adopted supplemental resolutions (the "Supplemental Resolutions") that apply the 2007 Resolutions to EDGX and EDGA in the same manner and to the same extent as the 2007 Resolutions apply to ISE LLC.<sup>17</sup> Accordingly, the Supplemental Resolutions, which are included in the Form 1 Applications, extend to EDGX and EDGA the commitments that the non-U.S. Upstream Owners made in the 2007 Resolutions with respect to ISE LLC.<sup>18</sup>

In addition, the Commission has approved changes to the U.S. Exchange Holdings Certificate and U.S. Exchange Holdings Bylaws, and to the ISE Holdings Certificate and ISE Holdings Bylaws, that apply these governing documents to any national securities exchange, or facility thereof, that U.S. Exchange Holdings or ISE Holdings, as applicable, controls, directly or indirectly, including EDGX and EDGA.<sup>19</sup>

The Commission believes that the Supplemental Resolutions, the U.S. Exchange Holdings Certificate and U.S. Exchange Holdings Bylaws, as amended, and the ISE Holdings Certificate and ISE Holdings Bylaws, as amended, will assist EDGX and EDGA

would be deemed to be the books and records of ISE LLC for purposes of and subject to oversight pursuant to the U.S. securities laws; and, that, for so long as they controlled ISE LLC, any change to their governing documents would be submitted to the board of directors of ISE LLC and, if ISE LLC determined that such change was required to be filed with the Commission, such change would not be effective until filed with, or filed with and approved by the Commission, in accordance with Section 19(b) of the Act.

<sup>17</sup> The enumeration in each of the 2007 Resolutions is identical. The enumeration in each of the Supplemental Resolutions also is identical. Therefore, unless otherwise specified, reference herein to certain enumerated resolutions applies to all of the 2007 Resolutions or to all of the Supplemental Resolutions, as applicable.

<sup>18</sup> *Id.*

<sup>19</sup> See Securities Exchange Act Release No. 61498 (February 4, 2010), 75 FR 7229 (February 18, 2010) (order approving File No. SR-ISE-2009-90) (revising the U.S. Exchange Holdings Certificate, the U.S. Exchange Holdings Bylaws, and the Trust Agreement among ISE Holdings, U.S. Exchange Holdings, and trustees) ("U.S. Exchange Holdings Order"); and DE Holdings Order, *supra* note 11 (revising the ISE Holdings Certificate and ISE Holdings Bylaws).

in fulfilling their self-regulatory obligations and in administering and complying with the requirements of the Act, as discussed in greater detail below.<sup>20</sup>

### 3. Swiss Resolutions and the 2009 Procedure

As discussed more fully in the Eurex Order,<sup>21</sup> Swiss law designed to protect Swiss sovereignty raised concerns about the ability of the Swiss Upstream Owners to provide the Commission with direct access to information, including books and records, related to the activities of ISE LLC.<sup>22</sup> To avoid conflict with Swiss law and to facilitate the 2007 Transaction, the Commission and the Swiss Federal Banking Commission ("SFBC") developed a procedure (the "2007 Procedure") under which the SFBC undertook to serve as a conduit for unfiltered delivery of books and records of the Swiss Upstream Owners related to the activities of ISE LLC.<sup>23</sup> Accordingly, each 2007 Resolution adopted by the Swiss Upstream Owners (the "2007 Swiss Resolutions") provided that, where necessitated by Swiss law, a Swiss Upstream Owner would provide information related to the activities of ISE LLC, including the books and records of such owner related to the activities of ISE LLC, to the Commission promptly through the SFBC.<sup>24</sup> Moreover, oral exchanges between each Swiss Upstream Owner and the Commission related to the activities of

<sup>20</sup> See Sections III.B. and III.C., *infra*.

<sup>21</sup> See note 13, *supra*.

<sup>22</sup> In particular, Art. 271 of the Swiss penal code, "Prohibited acts for a foreign state," states, in part: "Whoever, without being authorized, performs acts for a foreign state on Swiss territory that are reserved to an authority or an official, whoever performs such acts for a foreign party or another foreign organization, whoever aids and abets such acts, shall be punished with imprisonment and, in serious cases, sentenced to the penitentiary." See Eurex Order, *supra* note 13, at note 58 and accompanying text.

<sup>23</sup> See Eurex Order, *supra* note 13, at note 59 and accompanying text. On January 1, 2009, the SFBC, the Swiss Federal Office of Private Insurance, and the Swiss Anti-Money Laundering Control Authority merged to form the Swiss Financial Markets Authority ("FINMA"), a new consolidated financial regulator for Switzerland. The Eurex Order describes the 2007 Procedure in greater detail. See Eurex Order, *supra* note 13, at notes 57–60 and accompanying text.

<sup>24</sup> See Eurex Order, *supra* note 13, at note 57 and accompanying text. The 2007 Procedure was designed to ensure that the delivery of books and records to the Commission was not delayed. Therefore, under the 2007 Procedure, the Commission's requests for books and records would be sent directly to the Swiss Upstream Owners and would not be subject to filtering or substantive review by the SFBC. In addition, the SFBC agreed to pass to the Commission without delay and without substantive review materials provided by the Swiss Upstream Owners that were responsive to the Commission's requests for information. See Eurex Order, *supra* note 13, at note 60.

ISE LLC would include the participation of SFBC.<sup>25</sup>

By its terms, the 2007 Procedure applied solely to information of the Swiss Upstream Owners related to the activities of ISE LLC, including books and records related to the activities of ISE LLC. To accommodate the Swiss Upstream Owners' indirect ownership and voting interest in EDGX and EDGA, the Commission and FINMA (the successor to the SFBC) have developed a procedure (the "2009 Procedure") that is substantially similar to the 2007 Procedure, except that it will apply to any U.S. securities exchange, or facility thereof, that ISE Holdings controls, directly or indirectly, including EDGX and EDGA. The 2009 Procedure, which will become effective upon the Commission's approval of the Exchanges' Form 1 applications, will supersede the 2007 Procedure.

Under the 2009 Procedure, FINMA would serve as a conduit for the delivery of information of the Swiss Upstream Owners related to the activities of any registered national securities exchange controlled, directly or indirectly, by ISE Holdings, including EDGX and EDGA. The Commission's usual practice is to have direct access to books and records related to the activities of a U.S. securities exchange. However, subject to the condition that the Swiss Upstream Owners will promptly deliver such information to the Commission,<sup>26</sup> coupled with the fact that under Bylaws of the Exchanges, all trading records of the Exchanges must be maintained in the United States,<sup>27</sup> the Commission believes that the provisions of the 2007 Resolutions adopted by the Swiss Upstream Owners, as supplemented by the Supplemental Resolutions adopted by the Swiss Upstream Owners, related to the Commission's access to the books and records of the Swiss Upstream Owners through FINMA, should not result in a level of access materially different from that agreed to by other entities that control U.S. securities exchanges.<sup>28</sup>

<sup>25</sup> See Eurex Order, *supra* note 13, at text accompanying note 60.

<sup>26</sup> See 2007 Swiss Resolutions 1, 3(b), 6, 7(a), 7(e), 8(a), 8(e), and 9, and Swiss Supplemental Resolution 2.

<sup>27</sup> See Bylaws of EDGX ("EDGX Bylaws") and Bylaws of EDGA ("EDGA Bylaws") and, together with the EDGX Bylaws, the "Exchange Bylaws", Article XI, Section 4. The enumeration in the Exchange Bylaws is identical.

<sup>28</sup> See also Eurex Order, *supra* note 13, at note 66 and accompanying text. The Commission notes that if a non-U.S. Upstream Owner fails to make its books and record available to the Commission, the Commission could bring an action under, among other provisions, Section 17 of the Act, 15 U.S.C. 78q, and Rule 17a-1(b) thereunder, 17 CFR

#### 4. Trust Agreement

In connection with the 2007 Transaction, ISE implemented a Delaware statutory Trust (the "Trust") pursuant to a Trust Agreement ("2007 Trust Agreement") among ISE Holdings, U.S. Exchange Holdings, trustees (the "Trustees"), and a Delaware trustee.<sup>29</sup> By its terms, the 2007 Trust Agreement related solely to ISE Holdings' ownership of ISE LLC, but not to any other national securities exchange that ISE Holdings might control, directly or indirectly. The Commission has approved a proposal<sup>30</sup> that revises the 2007 Trust Agreement to replace references to ISE LLC with references to any national securities exchange or facility thereof controlled, directly or indirectly, by ISE Holdings, including EDGX and EDGA (the 2007 Trust Agreement, as amended, is referred to herein as the "2009 Trust Agreement").<sup>31</sup> Except for the expanded scope of the 2007 Trust Agreement, the 2009 Trust Agreement is substantially similar to the 2007 Trust Agreement.

The Trust serves two general purposes. First, for as long as ISE Holdings controls, directly or indirectly, a national securities exchange, including EDGX or EDGA, the Trust would hold capital stock of ISE Holdings in the event that a person obtains an ownership or voting interest in ISE Holdings in excess of the ownership and voting limits established in the ISE Holdings Certificate of Incorporation.<sup>32</sup> Second, the Trust would hold capital stock of ISE Holdings in the event of a Material Compliance Event.<sup>33</sup> Under the 2009 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 non-U.S. Upstream Owners to adhere to its

respective commitments under the 2007 Resolutions, as supplemented by the Supplemental Resolutions, in any material respect.<sup>34</sup> The 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.<sup>35</sup>

For the reasons discussed in the Eurex Order in connection with the 2007 Trust Agreement,<sup>36</sup> the Commission finds that the 2009 Trust Agreement is designed to enable EDGX and EDGA to operate in a manner that complies with the federal securities laws, including the objectives and requirements of sections 6(b) and 19(g) of the Act,<sup>37</sup> and to facilitate the ability of EDGX and EDGA and the Commission to fulfill their regulatory and oversight obligations under the Act.<sup>38</sup> In addition, the Commission notes that the 2009 Trust Agreement, like the 2007 Trust Agreement, is consistent with the provisions that other entities that directly or indirectly own or control a self-regulatory organization have instituted and that have been approved by the Commission.<sup>39</sup>

#### *B. Self-Regulatory Function of the Exchanges; Relationship Between DE Holdings, the Upstream Owners, ISE Holdings, and the Exchanges; Jurisdiction Over DE Holdings, ISE Holdings, and the Upstream Owners*

##### 1. DE Holdings

Although DE Holdings itself will not itself carry out regulatory functions, its activities with respect to the operation of EDGX and EDGA must be consistent with, and not interfere with, the self-regulatory obligations of EDGX and EDGA. The DE Holdings corporate

documents include certain provisions that are designed to maintain the independence of the Exchanges' self-regulatory function from DE Holdings, enable EDGX and EDGA to operate in a manner that complies with the federal securities laws, including the objectives of Sections 6(b) and 19(g) of the Act, and facilitate the ability of the Exchanges and the Commission to fulfill their regulatory and oversight obligations under the Act.<sup>40</sup>

For example, DE Holdings submits to the Commission's jurisdiction with respect to activities relating to EDGX and EDGA,<sup>41</sup> and agrees to provide the Commission and the Exchanges with access to its books and records that are related to the operation or administration of the Exchanges.<sup>42</sup> In addition, to the extent they are related to the operation or administration of EDGX or EDGA, the books, records, premises, officers, Managers, agents, and employees of DE Holdings shall be deemed the books, records, premises, officers, Managers, agents, and employees of EDGX or EDGA, as applicable, for purposes of, and subject to oversight pursuant to, the Act.<sup>43</sup> DE Holdings also agrees to keep confidential non-public information relating to the self-regulatory function<sup>44</sup> of the Exchanges and not to use such information for any non-regulatory purpose.<sup>45</sup> In addition, the Board of Managers of DE Holdings, as well as its officers, employees, and agents, are required to give due regard to the preservation of the independence of the self-regulatory function of EDGX and EDGA.<sup>46</sup> Further, the DE Holdings Operating Agreement requires that any changes to the DE Holdings Operating Agreement be submitted to the Boards of Directors of EDGX and EDGA, and, if such amendment is required to be filed with the Commission pursuant to Section 19(b) of the Act, such change shall not be effective until filed with, or filed with and approved by, the

240.17a-1(b), against EDGX or EDGA pursuant to Section 19(h) of the Act, 15 U.S.C. 78s(h).

<sup>29</sup> See Eurex Order, *supra* note 13, at Section II.C, for a more detailed description of the Trust.

<sup>30</sup> See U.S. Exchange Holdings Order, *supra* note 19.

<sup>31</sup> The term of the Trust is perpetual, provided that ISE Holdings directly or indirectly controls a national securities exchange or a facility thereof, including EDGX or EDGA. See 2009 Trust Agreement, Article II, Section 2.6.

<sup>32</sup> See Eurex Order, *supra* note 13, at Section II.C. If a person exceeds an ownership or voting limit, then 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 other matters (other than matters affecting the rights, preferences, or privileges of the capital stock) would automatically be transferred to the Trust. See ISE Holdings Certificate, Article FOURTH, Section III(c). See also Eurex Order, *supra* note 13, at note 37 and accompanying text.

<sup>33</sup> See Eurex Order, *supra* note 13, at Section II.C.

<sup>34</sup> See 2009 Trust Agreement, Article I, Section 1.1.

<sup>35</sup> See 2009 Trust Agreement, Article IV, Section 4.2. More specifically, if a Material Compliance Event occurs and continues to be in effect, the Trustees must take certain actions, including, after a 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. See 2009 Trust Agreement, Article IV, Section 4.2. See also Eurex Order, *supra* note 13, at note 62 and accompanying text.

<sup>36</sup> See Eurex Order, *supra* note 13, at Section II.C. See also U.S. Exchange Holdings Order, *supra* note 19.

<sup>37</sup> 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

<sup>38</sup> See 2009 Trust Agreement, Articles V, VI, and VIII.

<sup>39</sup> See, e.g., Securities Exchange Act Release Nos. 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.); and 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (File No. SR-NYSE-2005-77) (order relating to the business combination of the New York Stock Exchange, Inc., and Archipelago Holdings, Inc.). See also Eurex Order, *supra* note 13, at note 111.

<sup>40</sup> See DE Holdings Operating Agreement Article XI, Section 11.2; Article XII; and Article XIV.

<sup>41</sup> See DE Holdings Operating Agreement, Article XIV, Section 14.3.

<sup>42</sup> See DE Holdings Operating Agreement, Article XI, Section 11.2(b).

<sup>43</sup> *Id.*

<sup>44</sup> This requirement to keep confidential non-public information relating to the self-regulatory function shall not limit the Commission's ability to access and examine such information or limit the ability of any Members, Managers, officers, employees, or agents of DE Holdings to disclose such information to the Commission. See DE Holdings Operating Agreement, Article XI, Section 11.2(a).

<sup>45</sup> *Id.*

<sup>46</sup> See DE Holdings Operating Agreement, Article XIV, Section 14.1.

Commission.<sup>47</sup> The Commission finds that these provisions are consistent with the Act, and that they will assist EDGX and EDGA in fulfilling their self-regulatory obligations and in administering and complying with the requirements of the Act.

## 2. Upstream Owners and ISE Holdings

Although the Upstream Owners and ISE Holdings will not carry out any regulatory functions, the activities of each of the Upstream Owners and of ISE Holdings with respect to the operation of EDGX and EDGA must be consistent with, and not interfere with, the self-regulatory obligations of EDGX and EDGA. The 2007 Resolutions, as supplemented by the Supplemental Resolutions, the ISE Holdings Bylaws, the ISE Holdings Certificate, the U.S. Exchange Holdings Certificate, and the U.S. Exchange Holdings Bylaws include certain provisions designed to maintain the independence of the self-regulatory function of EDGX and EDGA, enable EDGX and EDGA 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>48</sup> and facilitate the ability of EDGX, EDGA, and the Commission to fulfill their regulatory and oversight obligations under the Act.

For example, the Upstream Owners and ISE Holdings provide that each such Upstream Owner, and ISE Holdings, will comply with the U.S. federal securities laws and the rules and regulations thereunder and cooperate with the Commission and EDGX and EDGA.<sup>49</sup> Also, each board member, officer, and employee of the Upstream Owners, and of ISE Holdings, in discharging his or her responsibilities, will comply with the U.S. federal securities laws and the rules and regulations thereunder, cooperate with the Commission, and cooperate with EDGX and EDGA.<sup>50</sup> In discharging his or her responsibilities as a board

member of an Upstream Owner, or of ISE Holdings, each such member must, to the fullest extent permitted by applicable law, take into consideration the effect that the actions of the Upstream Owner or ISE Holdings, as applicable, would have on the ability of EDGX and EDGA to carry out their responsibilities under the Act.<sup>51</sup> In addition, each of the Upstream Owners and ISE Holdings, and their board members, officers, and employees, must give due regard to the preservation of the independence of the self-regulatory function of EDGX and EDGA (or in the case of the non-U.S. Upstream Owners, that they will take reasonable steps necessary to cause their officers and employees involved in the activities of EDGX and EDGA to give due regard to preserving the independence of the self-regulatory functions of EDGX and EDGA).<sup>52</sup>

Further, the non-U.S. Upstream Owners (along with their respective board members, officers, and employees), U.S. Exchange Holdings, and ISE Holdings agree to keep confidential, to the fullest extent permitted by applicable law, all confidential information pertaining to the self-regulatory function of EDGX and EDGA, including, but not limited to, confidential information regarding disciplinary matters, trading data, trading practices, and audit information, contained in the books and records of EDGX or EDGA and not use such information for any commercial<sup>53</sup> purposes.<sup>54</sup> In addition, books and records of the non-U.S. Upstream Owners related to the activities of EDGX and EDGA will at all times be made available for, and books and records of U.S. Exchange Holdings and ISE Holdings will be subject at all times to, inspection and copying by the Commission, EDGX, and EDGA.<sup>55</sup> Books and records of U.S. Exchange Holdings

related to the activities of EDGX and EDGA, and the books and records of ISE Holdings, will be maintained within the United States.<sup>56</sup> Moreover, for so long as each of the Upstream Owners or ISE Holdings directly or indirectly controls EDGX or EDGA, the books, records, officers, directors (or equivalent), and employees of each of the Upstream Owners or of ISE Holdings will be deemed to be the books, records, officers, directors, and employees of EDGX or EDGA, as applicable.<sup>57</sup> Finally, for so long as U.S. Exchange Holdings or ISE Holdings directly or indirectly control EDGX or EDGA, the premises of U.S. Exchange Holdings and ISE Holdings will be deemed to be the premises of EDGX or EDGA.<sup>58</sup>

To the extent involved in the activities of EDGX or EDGA, each of the non-U.S. Upstream Owners, its board members, officers, and employees, irrevocably submit to the jurisdiction of the U.S. federal courts and the Commission for purposes of any action arising out of, or relating to, the activities of EDGX or EDGA.<sup>59</sup> Likewise, U.S. Exchange Holdings, its officers and directors, and employees whose principal place of business and residence is outside of the United States, to the extent such directors, officers, or employees are involved in the activities of EDGX or EDGA, irrevocably submit to the jurisdiction of the U.S. federal courts and the Commission for purposes of any action arising out of, or relating to, the activities of EDGX or EDGA.<sup>60</sup> Similarly, ISE Holdings and its officers, directors, employees, and agents irrevocably submit to the jurisdiction of the U.S. federal courts and the Commission for purposes of any action arising out of, or relating to, EDGX or EDGA.<sup>61</sup>

Finally, the 2007 Resolutions, as supplemented by the Supplemental Resolutions, the U.S. Exchange Holdings Certificate, the U.S. Exchange Holdings Bylaws, the ISE Holdings Certificate, and the ISE Holdings Bylaws each require that any change to the applicable document (including any action by the non-U.S. Upstream

<sup>47</sup> See DE Holdings Operating Agreement, Article XV, Section 15.2(b). The requirement to submit changes to the Board of an Exchange endures for as long as DE Holdings directly or indirectly controls the Exchange. *Id.*

<sup>48</sup> 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

<sup>49</sup> See Resolution 1 and Supplemental Resolution 2(a); U.S. Exchange Holdings Certificate, Article ELEVENTH; and ISE Holdings Certificate, Article THIRTEENTH.

<sup>50</sup> See Resolutions 7(a) and 8(a) and Supplemental Resolutions 2(b) and (c); U.S. Exchange Holdings Certificate, Article TENTH; and ISE Holdings Certificate, Article TENTH. The Resolutions also provide that each non-U.S. Upstream Owner will take reasonable steps necessary to cause each person who subsequently becomes a board member of the non-U.S. Upstream Owner to agree in writing to certain matters included in the Resolutions. See Resolution 7 and Supplemental Resolution 2(b).

<sup>51</sup> Resolution 7(f) and Supplemental Resolution 2(b); U.S. Exchange Holdings Certificate, Article TENTH; and ISE Holdings Certificate, Article TENTH.

<sup>52</sup> See Resolutions 5, 7(d), and 8(d) and Supplemental Resolution 2; U.S. Exchange Holdings Certificate, Article TWELFTH; and ISE Holdings Bylaws, Article I, Section 1.5.

<sup>53</sup> The Commission believes that any non-regulatory use of such information would be for a commercial purpose.

<sup>54</sup> See Resolutions 6, 7(e), and 8(e), and Supplemental Resolution 2; U.S. Exchange Holdings Certificate, Article FOURTEENTH; and ISE Holdings Certificate, Article ELEVENTH.

<sup>55</sup> See Resolution 3 and Supplemental Resolution 2(a); U.S. Exchange Holdings Certificate, Article FIFTEENTH; and ISE Holdings Certificate, Article TWELFTH. See Section II.A.3, *supra*, for a discussion of the 2009 Procedure through which the Swiss Upstream Owners would make available their books and records relating to the activities of the Exchanges.

<sup>56</sup> See U.S. Exchange Holdings Certificate, Article FIFTEENTH; and ISE Holdings Bylaws, Article I, Section 1.3.

<sup>57</sup> See Resolutions 3 and 8(c) and Supplemental Resolutions 2(a) and (c); U.S. Exchange Holdings Certificate, Article FIFTEENTH; and ISE Holdings Certificate, Article TWELFTH.

<sup>58</sup> See U.S. Exchange Holdings Certificate, Article FIFTEENTH; and ISE Holdings Certificate, Article TWELFTH.

<sup>59</sup> See Resolutions 2, 7(b), and 8(b) and Supplemental Resolution 2.

<sup>60</sup> See U.S. Exchange Holdings Bylaws, Article VI, Section 16.

<sup>61</sup> See ISE Holdings Bylaws, Article I, Section 1.4.

Owners that would have the effect of changing the Supplemental Resolutions or the 2007 Resolutions) be submitted to the Boards of EDGX and EDGA.<sup>62</sup> If such change must be filed with, or filed with and approved by, the Commission under Section 19 of the Act,<sup>63</sup> and the rules thereunder, then such change shall not be effective until filed with, or filed with and approved by, the Commission.<sup>64</sup> The Commission finds that these provisions are consistent with the Act, and that they will assist EDGX and EDGA in fulfilling their self-regulatory obligations and in administering and complying with the requirements of the Act.

### 3. Controlling Persons

Under Section 20(a) of the Act, any person with a controlling interest in EDGX or EDGA would be jointly and severally liable with and to the same extent that EDGX or EDGA 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 creates aiding and abetting liability for any person who knowingly 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. These provisions are applicable to all entities controlling the Exchanges, including the Trust, DE Holdings, ISE Holdings, and the Upstream Owners.

### C. Ownership and Voting Limitations; Changes in Control of the Exchanges

The DE Holdings Certificate includes restrictions on the ability to own and vote shares of the capital stock of DE Holdings.<sup>65</sup> These limitations are

designed to prevent any Member of DE Holdings from exercising undue control over the operation of the Exchanges and to assure that the Exchanges and the Commission are able to carry out their regulatory obligations under the Act. Similarly, the corporate governing documents of ISE Holdings include ownership and voting limitations (respectively, the "ISE Holdings Ownership Limit" and the "ISE Holdings Voting Limit") that apply for so long as ISE Holdings controls, directly or indirectly, a national securities exchange, including EDGX or EDGA. The Resolutions and Supplemental Resolutions of the non-U.S. Upstream Owners, and the U.S. Exchange Holdings Certificate of Incorporation, include provisions requiring these entities to take reasonable steps necessary to cause ISE Holdings to be in compliance with the ISE Holdings Ownership Limit and the ISE Holdings Voting Limit.

### 1. DE Holdings

Generally, no person, other than ISE Holdings, either alone or together with its related persons,<sup>66</sup> may own, directly or indirectly, of record or beneficially, Units representing more than a 40% Percentage Interest in DE Holdings.<sup>67</sup> In addition, the DE Holdings Operating Agreement prohibits members of the EDGX or EDGA, either alone or together with their related persons, from owning, directly or indirectly, of record or beneficially, Units representing a Percentage Interest in DE Holdings of

more than 20%.<sup>68</sup> Further, no person, other than ISE Holdings, either alone or together with its related persons, may vote or cause the voting of Units representing more than a 20% Percentage Interest in DE Holdings.<sup>69</sup> If any Member of DE Holdings purports to transfer Units in violation of the ownership limits, or to vote or cause the voting of Units in violation of the voting limits, DE Holdings has the right to redeem such Units for the lesser of the fair market value or the book value of the Units.<sup>70</sup> In addition, DE Holdings will not honor any vote that would violate the voting limitations, and any Units that would violate the voting limitation will not be entitled to vote to the extent of the violation.<sup>71</sup>

The DE Holdings Board may waive the 40% ownership limitation applicable to persons who are not Exchange members and the 20% voting limitation pursuant to an amendment to the DE Holdings Operating Agreement adopted by the DE Holdings Board if the DE Holdings Board makes certain findings.<sup>72</sup> Any such amendment will not be effective unless it is filed with and approved by the Commission.<sup>73</sup> However, as long as DE Holdings directly or indirectly controls an Exchange, the DE Holdings Board may not waive the ownership and voting limitations above 20% for Exchange members or their related persons.<sup>74</sup>

Exchange members that trade on an exchange traditionally have ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.<sup>75</sup> A member that is a controlling shareholder of an exchange

Securities Exchange Act Release Nos. 58375 (August 18, 2008), 73 FR 49498 (August 21, 2008) (File No. 10-182) (order granting the exchange registration of BATS Exchange, Inc.) ("BATS Exchange Order"); 53963 (June 8, 2006), 71 FR 34660 (June 15, 2006) (File No. SR-NSX-2006-03) ("NSX Demutualization Order"); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (File No. SR-CHX-2004-26) ("CHX Demutualization Order"); and 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (File No. SR-Phlx-2003-73) ("Phlx Demutualization Order").

<sup>66</sup> See DE Holdings Operating Agreement, Article I, Section 1.1.

<sup>67</sup> See DE Holdings Operating Agreement, Article XII, Section 12.1(a). A Percentage Interest is the ratio of the number of Units held to the total of all of the issued and outstanding Units, expressed as a percentage. See DE Holdings Operating Agreement, Article I, Section 1.1. The ownership and voting limitations in Article XII, Section 12.1(a) of the DE Holdings Operating Agreement will not apply to ISE Holdings for as long as ISE LLC is a wholly-owned subsidiary of ISE Holdings and ISE Holdings is subject to ownership and voting limitations comparable to those set forth in Article XII, Section 12.1(a). See DE Holdings Operating Agreement, Article XII, Section 12.1(a)(3). The comparable ownership and voting limitations for ISE Holdings are included in Article FOURTH, Section III of the ISE Holdings Certificate. See also notes 89-91, *infra*, and accompanying text.

<sup>68</sup> See DE Holdings Operating Agreement, Article XII, Section 12.1(a)(2).

<sup>69</sup> See DE Holdings Operating Agreement, Article XII, Section 12.1(a)(3).

<sup>70</sup> See DE Holdings Operating Agreement, Article XII, Section 12.3.

<sup>71</sup> See DE Holdings Operating Agreement, Article XII, Section 12.4.

<sup>72</sup> See DE Holdings Operating Agreement, Article XII, Section 12.1(b).

<sup>73</sup> *Id.*

<sup>74</sup> These provisions are consistent with waiver of ownership and voting limits approved by the Commission for other SROs. See e.g., BATS Exchange Order, NSX Demutualization Order, and CHX Demutualization Order, *supra* note 65; and Securities Exchange Act Release No. 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (File No. SR-PCX-2004-08).

<sup>75</sup> See, e.g., Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131) ("Nasdaq Exchange Order"); and 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) ("NYSE/Archipelago Merger Approval Order").

<sup>62</sup> See Supplemental Resolution 3; U.S. Exchange Holdings Certificate, Article SIXTEENTH; U.S. Exchange Holdings Bylaws, Article VI, Section 9; ISE Holdings Certificate, Article FOURTEENTH; and ISE Holdings Bylaws, Article X, Section 10.1.

<sup>63</sup> 15 U.S.C. 78s.

<sup>64</sup> See Supplemental Resolution 3; U.S. Exchange Holdings Certificate, Article SIXTEENTH; U.S. Exchange Holdings Bylaws, Article VI, Section 9; ISE Holdings Certificate, Article FOURTEENTH; and ISE Holdings Bylaws, Article X, Section 10.1. The requirement to submit changes to the Board of an Exchange endures for as long as the Upstream Owners or ISE Holdings directly or indirectly control the Exchange. *Id.*

<sup>65</sup> These provisions are consistent with ownership and voting limits approved by the Commission for other self-regulatory organizations. See e.g.,



might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions.

In addition, as proposed, the Exchanges will be wholly-owned subsidiaries of DE Holdings. The Amended and Restated Bylaws of EDGX and EDGA (together, the "Exchanges Amended and Restated Bylaws") identify this ownership structure.<sup>76</sup> Any changes to the Exchanges Amended and Restated Bylaws, including any change in the provision that identifies DE Holdings as the initial owner of the Exchanges, must be filed with and approved by the Commission pursuant to Section 19 of the Act.<sup>77</sup>

The Commission believes that these provisions are consistent with the Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or the Exchanges to effectively carry out their regulatory oversight responsibilities under the Act.

In its comment letter, Nasdaq raises questions relating to the ownership and control of EDGX and EDGA, in particular, and of national securities exchanges in general. In this regard, Nasdaq urges the Commission to re-examine the voting and ownership limits applicable to owners of national securities exchanges and to adopt consistent rules that would apply to all national securities exchanges and alternative trading systems.<sup>78</sup> In addition, Nasdaq asks the Commission to consider the possibility that multiple owners, each holding a 20% ownership interest, could have common interests that cause them to act in concert on a consistent basis.<sup>79</sup> In the case of EDGX and EDGA, Nasdaq believes that "the bias inherent in concentrated dealer control" could affect the operation of the Exchanges and of their Member/owners,

thereby requiring the Commission to review all proposed rule changes of the Exchanges for possible bias.<sup>80</sup>

As discussed above,<sup>81</sup> the DE Holdings Operating Agreement includes restrictions on the ability to own and vote Units in DE Holdings. The Commission believes that these limitations, which are consistent with the ownership and voting limits that the Commission has approved for other SROs,<sup>82</sup> are reasonably designed to prevent any member of DE Holdings, including the Member/owners, from exercising undue control over the operation of the Exchanges. In addition, the Commission believes that the composition of the Exchanges' Boards of Directors, which must at all times include a majority of Independent Directors, could help to counteract the influence of the Exchanges' Member/owners.<sup>83</sup> With respect to Nasdaq's concern regarding the need to scrutinize proposed rule changes of EDGX and EDGA for possible bias in favor of the Exchanges' Member/owners, the Commission notes that that it will review proposed rule changes by the Exchanges, as it reviews the proposed rule changes of all other national securities exchanges, to evaluate whether the proposed rules are consistent with Act, in general, and, in particular, with the requirements of Section 6(b)(5) of the Act.<sup>84</sup>

Nasdaq also expresses concern regarding potential unfair advantages resulting from exchanges of information between the Exchanges and their Member/owners.<sup>85</sup> In particular, Nasdaq questions how the Exchanges will implement the provisions of Exchange Rules 2.10 and 2.11<sup>86</sup> and Exchange Amended and Restated Bylaws Article XI which, among other things, restrict the flow of confidential information between the Exchanges and other

persons, in light of the potential presence of representatives of each of the controlling owners on the Exchange Boards. The Commission notes that Exchange Rules 2.10 and 2.11 are comparable to rules adopted by other national securities exchanges<sup>87</sup> and that Article XI, Section 3 of the Exchange Amended and Restated Bylaws is comparable to bylaw provisions adopted by other national securities exchanges.<sup>88</sup> The Commission notes that each Exchange, like all national securities exchanges, has the obligation under Section 6(b)(1) of the Act to comply with its rules and to enforce compliance by Exchange Members with, among other things, the rules of the Exchange and the federal securities laws. Accordingly, if either Exchange learns of a failure to maintain the confidentiality of information pertaining to its self-regulatory function, as required by the Exchanges Amended and Restated Bylaws and the DE Holdings Operating Agreement, such Exchange would be required to take appropriate action to address the failure to comply with the applicable requirements of its governing documents. In addition, the Commission also monitors national securities exchanges with respect to their members' compliance with the rules of the exchange.

## 2. ISE Holdings and the Upstream Owners

### (a) ISE Holdings

The governing documents of ISE Holdings also include ownership and voting limitations that apply for so long as ISE Holdings controls, directly or indirectly, a national securities exchange (a "Controlled National Securities Exchange"), or facility thereof, including EDGX or EDGA. In particular, the ISE Holdings Certificate provides that, for so long as ISE Holdings controls, directly or indirectly, a Controlled National Securities exchange, no person, either alone or together with its related persons, may own, directly or indirectly, of record or beneficially, more than 40% (or 20% if the person is a member of an exchange controlled by ISE Holdings) of the capital stock of ISE Holdings that has the right by its terms to vote in the election of the Board of Directors of ISE Holdings ("ISE Holdings Board") or on other matters (other than matters affecting the rights, preferences, or

<sup>76</sup> See Exchanges Amended and Restated Bylaws Article II(j). The enumeration in the Amended and Restated Bylaws of EDGX and EDGA is identical.

<sup>77</sup> See 15 U.S.C. 78s.

<sup>78</sup> See Nasdaq Letter, *supra* note 4, at 3. Credit Suisse, however, believes that Commission rules governing the ownership structure of alternative trading systems are unnecessary and would be inconsistent with the goals of Regulation ATS. See Credit Suisse Letter, *supra* note 4. The Commission does not believe that the consideration of the Exchanges' applications for exchange registration are the appropriate forum for considering this issue.

<sup>79</sup> *Id.* at 4. In this regard, Nasdaq notes that three broker-dealers each hold a 19.9% ownership interest in DE Holdings. See Nasdaq Letter, *supra* note 4, at 2.

<sup>80</sup> See Nasdaq Letter, *supra* note 4, at 4.

<sup>81</sup> See notes 65–77, *supra*, and accompanying text.

<sup>82</sup> See note 65, *supra*.

<sup>83</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(b). The composition of the Exchanges' Boards is discussed in greater detail in Section II.D.1., *infra*.

<sup>84</sup> 15 U.S.C. 78f(b)(5).

<sup>85</sup> See Nasdaq Letter, *supra* note 4, at 5.

<sup>86</sup> Exchange Rule 2.10, "Affiliation between Exchange and a Member," generally prohibits an Exchange from acquiring an ownership interest in a Member, and a Member from becoming an affiliate of the Exchange, without prior Commission approval. Exchange Rule 2.10 allows an Exchange Member to be a Director of the Exchange or of DE Holdings. In addition, Exchange Rule 2.10 allows each Exchange to be an affiliate of DECN. Exchange Rule 2.11, "Direct Edge ECN LLC as Outbound Router," addresses DECN's function as the outbound router for the Exchanges. Exchange Rules 2.10 and 2.11 are discussed in greater detail in Section III.G, *infra*.

<sup>87</sup> See, e.g., BATS Rules 2.10 and 2.11; and NSX Rules 2.10 and 2.11. Exchange Rules 2.10 and 2.11 are discussed in greater detail in Section III.G, *infra*.

<sup>88</sup> See, e.g., Article XI, Section 3 of the Amended and Restated Bylaws of BATS Exchange, Inc.

privileges of the capital stock) ("ISE Holdings Ownership Limit").<sup>89</sup> In addition, for so long as ISE Holdings controls, directly or indirectly, a Controlled National Securities Exchange, no person, either alone or together with its related persons, may, directly or indirectly, vote or cause the voting of more than 20% of the ISE Holdings capital stock that has the right by its terms to vote in the election of the ISE Holdings Board or on other matters (other than matters affecting the rights, preferences, or privileges of the capital stock) ("ISE Holdings Voting Limit").<sup>90</sup>

Article XI of the ISE Holdings Bylaws, which originally was adopted in connection with the Eurex Transaction, waives the ISE Holdings Ownership Limits and the ISE Holdings Voting Limits to allow the Upstream Owners to own and vote all of the common stock of ISE Holdings.<sup>91</sup> Article XI, Section 11.1(b) states that, in waiving the ISE Holdings Ownership Limits and the ISE Holdings 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 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); and (v)

neither the Upstream Owner nor any of its related persons is a member of such Controlled National Securities Exchange.

Because Article XI, Section 11.1(b) requires the ISE Holdings Board, in waiving the ISE Holdings Ownership Limit and the ISE Holdings Voting Limit, to have determined, with respect to each Upstream Owner, that, among other things, such waiver will not impair the ability of EDGX and EDGA to carry out their functions and responsibilities under the Act, or impair the Commission's ability to enforce the Act, the Commission believes that the Upstream Owners' exercise of ownership and voting control of ISE Holdings will not impair the ability of the Commission or of EDGX and EDGA to discharge their respective responsibilities under the Act.

#### (b) Upstream Owners

To facilitate compliance with the ISE Holdings Ownership Limit and the ISE Holdings Voting Limit, the Resolutions of the non-U.S. Upstream Owners, as supplemented by the Supplemental Resolutions, provide that each such owner will take reasonable steps necessary to cause ISE Holdings to be in compliance with the ISE Holdings Ownership Limit and the ISE Holdings Voting Limit.<sup>92</sup> Likewise, the U.S. Exchange Holdings Certificate provides that, for so long as U.S. Exchange Holdings directly or indirectly controls a national securities exchange, including EDGX or EDGA, U.S. Exchange Holdings will take reasonable steps necessary to cause ISE Holdings to be in compliance with the ISE Holdings Ownership Limit and the ISE Holdings Voting Limit.<sup>93</sup> The Commission believes that these provisions in the Resolutions, as supplemented by the Supplemental Resolutions, and in the U.S. Exchange Holdings Certificate should minimize the potential that a person could improperly interfere with, or restrict the ability of, the Commission or EDGX or EDGA to effectively carry out their regulatory responsibilities under the Act.

#### D. EDGX and EDGA

EDGX and EDGA each have applied to the Commission to register as a national securities exchange. As part of their exchange applications, EDGX and EDGA have filed their Certificates of Incorporation (together, the "Exchange Certificates") and the Exchanges

Amended and Restated Bylaws.<sup>94</sup> In these documents, among other things, the Exchanges establish the composition of their respective Boards of Directors (each, an "Exchange Board," and, together, the "Exchange Boards") and the committees of the Exchanges.

#### 1. Exchange Boards

Each Exchange Board will be the governing body of its Exchange and will possess all of the powers necessary for the management of the business and affairs of the Exchange and the execution of the Exchange's responsibilities as a self-regulatory organization ("SRO"). Under the Exchanges Amended and Restated Bylaws, each Exchange Board initially will be composed of 19 Directors, including:<sup>95</sup>

- The Chief Executive Officer ("CEO") of EDGX or EDGA, as applicable;<sup>96</sup>
- Four Owner Directors;<sup>97</sup>
- Ten Independent Directors;<sup>98</sup> and
- Four Exchange Member Directors.<sup>99</sup>

In addition, at all times, at least 20% of the Directors of each Exchange Board will be Exchange Member Directors and the majority of the Directors of each Exchange Board will be Independent Directors.<sup>100</sup>

<sup>94</sup> The enumeration in the EDGX Certificate and the EDGX Amended and Restated Bylaws are the same as the enumeration in the EDGA Certificate and the EDGA Amended and Restated Bylaws, respectively.

<sup>95</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(a). An Exchange Board may add or remove Director positions, provided that, among other things, the number of Directors positions will not be fewer than seven nor more than 25. See Exchanges Amended and Restated Bylaws, Article III, Section 2(b).

<sup>96</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(a)(i).

<sup>97</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(a)(ii). The Designating Owners of DE Holdings (*i.e.*, Members of DE Holdings that hold at least a 15% Percentage Interest in DE Holdings) select the Owner Directors. See Exchanges Amended and Restated Bylaws, Articles I(k) and III, Section 2(b).

<sup>98</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(a)(iii). An Independent Director is a Director who has no material relationship with (i) the Exchange or any Affiliate of the Exchange, or (ii) any Exchange Member or Affiliate of any Exchange Member; *provided*, however, that an individual who otherwise qualifies as an Independent Director will not be disqualified from serving in such capacity solely because such Director is a Director of the Exchange, DE Holdings, or, the case of EDGA, a Director of EDGX and, in the case of EDGX, a Director of EDGA. See Exchanges Amended and Restated Bylaws, Article I(u).

<sup>99</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(a)(iv). An Exchange Member Director is an officer, director, employee or agent of an Exchange Member who is elected in accordance with the procedures set forth in Article III, Section 4 of the Exchanges Amended and Restated Bylaws. See Exchanges Amended and Restated Bylaws, Article I(q).

<sup>100</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 2(b).

<sup>89</sup> See ISE Holdings Certificate, Article FOURTH, Section III.

<sup>90</sup> *Id.* If a person exceeds an ISE Holdings Ownership or ISE Holdings 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 other matters (other than matters affecting the rights, preferences or privileges of the capital stock) would automatically be transferred to the Trust. See ISE Holdings Certificate, Article FOURTH, Section III(c). See also Eurex Order, *supra* note 13, at note 36 and at notes 70–114 and accompanying text.

<sup>91</sup> The ISE Holdings Certificate allows the ISE Holdings Board to waive the ISE Holdings Ownership Limit and the ISE Holdings Voting Limit 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 was adopted in connection with the Eurex Transaction, when ISE LLC was the sole national securities exchange controlled by ISE Holdings. See Eurex Order, *supra* note 13. Article XI, Section 11.1(b) was subsequently amended to apply to any Controlled National Securities Exchange. See DE Holdings Order, *supra* note 11.

<sup>92</sup> See Resolution 4 and Supplemental Resolution 2(a).

<sup>93</sup> See U.S. Exchange Holdings Certificate, Article THIRTEENTH.



Following approval of the Form 1 Applications, DE Holdings, as the sole owner of the common stock of the Exchanges, will elect Directors in accordance with the Exchange Certificates and the Exchanges Amended and Restated Bylaws.<sup>101</sup> The first annual meeting of the stockholders of each Exchange will be held prior to the Exchanges' commencement of operations as national securities exchanges.<sup>102</sup> At the first annual stockholders' meeting, the stockholders will elect Directors of the Exchanges pursuant to the Exchange Certificates and the Exchanges Amended and Restated Bylaws. Therefore, prior to commencing operations as national securities exchanges, the Members of the Exchanges will have the opportunity to participate in the selection of Exchange Member Directors.<sup>103</sup>

DE Holdings will appoint the initial Nominating Committee<sup>104</sup> and the Exchange Member Nominating Committee<sup>105</sup> for each Exchange, which will serve until the first annual meeting of stockholders.<sup>106</sup> Each of the Nominating Committee and the Exchange Member Nominating Committee, after completion of its respective duties for nominating directors for election to the Board of EDGX or EDGA, as applicable, for that year, will nominate candidates to serve on the succeeding year's Nominating Committee or Member Nominating Committee, as applicable.<sup>107</sup> Additional candidates for the Member Nominating Committee may be nominated and elected by each Exchange's Members pursuant to a petition process.<sup>108</sup>

Each Exchange's Nominating Committee will nominate candidates for each director position (other than Owner Directors, Exchange Member Directors, and the director position filled by the CEO), and DE Holdings, as the sole shareholder, will elect those directors. Each Exchange's Member Nominating Committee will nominate candidates for each Exchange Member Director on the Exchange Board.<sup>109</sup> Members of EDGX and EDGA may nominate additional candidates for the Exchange Member Director positions pursuant to a petition process.<sup>110</sup> If no candidates are nominated pursuant to a petition process, then each Exchange's Nominating Committee will nominate the initial nominees of the Member Nominating Committee as Exchange Member Directors.<sup>111</sup> If a petition process produces additional candidates, then the candidates nominated pursuant to the petition process, together with those nominated by each Exchange's Member Nominating Committee, will be presented to Exchange Members for election to determine the final nomination of Exchange Member Directors.<sup>112</sup> Each Exchange's Nominating Committee will nominate the candidates who receive the most votes as Exchange Member Directors.<sup>113</sup> DE Holdings, as the sole shareholder, will elect those candidates nominated by each Exchange's Nominating Committee as Exchange Member Directors.<sup>114</sup>

The Commission believes that the requirement in the Exchanges Amended and Restated By-Laws that 20% of the directors be Exchange Member Directors and the means by which they are chosen by Members provides for the fair representation of members in the

selection of directors and the administration of the Exchanges consistent with the requirement in Section 6(b)(3) of the Act.<sup>115</sup> As the Commission has previously noted, this requirement helps to ensure that members have a voice in the use of self-regulatory authority, and that an exchange is administered in a way that is equitable to all those who trade on its market or through its facilities.<sup>116</sup>

The Commission has previously stated its belief that the inclusion of public, non-industry representatives on exchange oversight bodies is critical to an exchange's ability to protect the public interest.<sup>117</sup> Further, public, non-industry representatives help to ensure that no single group of market participants has the ability to systematically disadvantage other market participants through the exchange governance process. The Commission believes that public directors can provide unique, unbiased perspectives, which should enhance the ability of the Exchange Boards to address issues in a non-discriminatory fashion and foster the integrity of the Exchanges.<sup>118</sup> The Commission believes that the composition of the Exchange Boards satisfy the requirements in Section 6(b)(3) of the Act,<sup>119</sup> which requires that one or more directors be representative of issuers and investors and not be associated with a member of the exchange, or with a broker or dealer.<sup>120</sup>

## 2. Exchange Committees

In the Exchanges Amended and Restated Bylaws, the Exchanges have proposed to establish several committees. Specifically, each Exchange has proposed to establish the following committees whose members the Exchange Boards, after consultation with the Chairman, may designate: a Compensation Committee;<sup>121</sup> an Audit

<sup>101</sup> See Form 1 Applications, Exhibit J, Response 2.

<sup>102</sup> See Exchanges Amended and Restated Bylaws, Article IV, Section 1(b).

<sup>103</sup> See Exchanges Amended and Restated Bylaws, Article III, Sections 2 and 4.

<sup>104</sup> The Nominating Committee will consist solely of three Independent Directors. See Exchanges Amended and Restated Bylaws, Article VI, Section 2. Because the Exchanges Amended and Restated Bylaws are substantially the same, the discussion of the Exchanges' committees applies to both Exchanges.

<sup>105</sup> Each member of the Exchange Member Nominating Committee will qualify as an Exchange Member Director, although the committee member is not required to be a Director. See Exchanges Amended and Restated Bylaws, Article VI, Section 3. An Exchange Member Director is an officer, director, employee, or agent of an Exchange Member, other than an Exchange Member that maintains an ownership interest in DE Holdings, who is elected as a Director in accordance with Article III, Section 4 of the Exchanges Amended and Restated Bylaws. See Exchanges Amended and Restated Bylaws, Article I(q) and (z).

<sup>106</sup> See Exchanges Amended and Restated Bylaws, Article VI, Section 1.

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

<sup>109</sup> The Exchange Member Nominating Committee will solicit comments from Exchange members for the purpose of approving and submitting names of candidates for election to the position of Exchange Member Director. See Exchanges Amended and Restated Bylaws, Article III, Section 4.

<sup>110</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 4(c). The petition must be signed by Exchange Member Representatives representing 10% or more of the Exchange members. No Exchange member, together with its Affiliates, may account for more than 50% of the signatures endorsing a particular candidate. *Id.*

<sup>111</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 4(e).

<sup>112</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 4(e) and (f). Each Exchange Member will have the right to cast one vote for each available Exchange Member Director nomination, provided that any such vote must be cast for a person on the List of Candidates, and no Exchange Member, together with its Affiliates, may account for more than 20% of the votes cast for a candidate. See Exchanges Amended and Restated Bylaws, Article III, Section 4(f).

<sup>113</sup> See Exchanges Amended and Restated Bylaws, Article III, Section 4(f).

<sup>114</sup> *Id.*

<sup>115</sup> 15 U.S.C. 78f(b)(3).

<sup>116</sup> See, e.g., Nasdaq Exchange Registration Order and NYSE/Archipelago Merger Approval Order, *supra* note 75, and BATS Exchange Order, *supra* note 65.

<sup>117</sup> See, e.g., 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").

<sup>118</sup> See Nasdaq Exchange Registration Order and NYSE/Archipelago Merger Approval Order, *supra* note 75, and BATS Exchange Order, *supra* note 65.

<sup>119</sup> 15 U.S.C. 78f(b)(3).

<sup>120</sup> See Form 1 Applications, Exhibit J, Response 2 (stating that at least one Independent Director will be a public non-industry representative not associated with a member of the Exchange or with a broker or dealer, as required by Section 6(b)(3) of the Act).

<sup>121</sup> The Compensation Committee will consist of three Independent Directors. See Exchanges

Committee;<sup>122</sup> an Executive Committee;<sup>123</sup> a Regulatory Oversight Committee; and an Appeals Committee.<sup>124</sup> In addition, each Exchange has proposed to establish a Nominating Committee<sup>125</sup> and a Member Nominating Committee, which will be elected on an annual basis by a vote of the stockholders.<sup>126</sup> For the reasons discussed above, the Commission believes that the Exchanges' proposed committees should enable the Exchanges to carry out their responsibilities under the Act and are consistent with the Act.

#### *E. Regulation of EDGX and EDGA*

As a prerequisite for the Commission's approval of an exchange's application for registration, an exchange must be organized and have the capacity to carry out the purposes of the Act.<sup>127</sup> Among other requirements, an exchange must be able to enforce compliance by its members, and persons associated with its members, with the federal securities laws and the rules of the exchange.<sup>128</sup>

##### 1. Membership

Membership on the Exchanges will be open to any registered broker or dealer that is a member of another registered national securities exchange or association, or any natural person associated with such a registered broker or dealer.<sup>129</sup> To be eligible for membership in the Exchanges, a person must be, and remain, a member of another registered national securities exchange or association.<sup>130</sup>

For a temporary 90-day period after approval of the Exchanges' Form 1 Applications, an applicant that is an

active member of another registered national securities exchange or the Financial Industry Regulatory Authority, Inc. ("FINRA") and is a current or former subscriber to DECEN will be able to apply through an expedited process to become a member of one or both Exchanges, and to register with the Exchange(s) all of its associated persons whose registrations are active at the time the Exchanges are approved as national securities exchanges, by submitting waive-in application forms, including membership agreements.<sup>131</sup> EDGX or EDGA may request additional documentation in addition to the waive-in application form in order to determine whether a waive-in applicant meets the Exchange's qualification standards.<sup>132</sup> All of the firm's associated persons who are registered in categories recognized by Exchange rules would become registered persons of an Exchange member firm.<sup>133</sup>

All other applicants (and after the 90-day period has ended, those that could have waived in through the expedited process) may apply for membership in one or both Exchanges by submitting a full membership application to the Exchange(s).<sup>134</sup> Applications for association with an Exchange Member shall be submitted to the Exchange(s) on Form U-4 and such other forms as the Exchanges may prescribe.<sup>135</sup>

Each Exchange will receive and review all applications for membership in the Exchange. If an Exchange is satisfied that the applicant is qualified for membership, the Exchange will promptly notify the applicant, in writing, of such determination, and the applicant will be a member of the Exchange.<sup>136</sup> If an Exchange is not satisfied that the applicant is qualified for membership, the Exchange shall promptly notify the applicant of the grounds for denial.<sup>137</sup> Once an applicant is a member of an Exchange, it must continue to possess all the qualifications set forth in the Exchange's rules. When an Exchange has reason to believe that an Exchange member or associated person of a member fails to meet such qualifications, the Exchange may suspend or revoke such person's membership or association.<sup>138</sup>

Appeal of a staff denial, suspension, or termination of membership will be heard by the Appeals Committee of EDGX or EDGA, as applicable.<sup>139</sup> Decisions of the Appeals Committee will be made in writing and will be sent to the parties to the proceeding.<sup>140</sup> The decisions of the Appeals Committee will be subject to review by the applicable Exchange Board, on its own motion, or upon written request by the aggrieved party or by the Chief Regulatory Officer ("CRO").<sup>141</sup> The Exchange Board will have sole discretion to grant or deny the request.<sup>142</sup> The Exchange Board will conduct the review of the Appeals Committee's decision and may affirm, reverse, or modify the Appeals Committee's decision.<sup>143</sup> An Exchange Board's decision is final.<sup>144</sup>

The Commission finds that the membership rules of EDGX and EDGA<sup>145</sup> are consistent with section 6 of the Act,<sup>146</sup> specifically section 6(b)(2) of the Act,<sup>147</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer or natural person associated with such broker or dealer may become a member and any person may become associated with an exchange member. The Commission notes that pursuant to section 6(c) of the Act, 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 registered exchanges, the Exchanges 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>148</sup>

Amended and Restated Bylaws, Article V, Section 5(a).

<sup>122</sup> The Audit Committee, which will have at least three members, will consist solely of Directors, including a majority of Independent Directors, and an Independent Director will serve as Chairman of the Audit Committee. See Exchanges Amended and Restated Bylaws, Article V, Sections 2(a) and 5(b).

<sup>123</sup> The Regulatory Oversight Committee will have at least three members and will consist solely of Independent Directors. See Exchanges Amended and Restated Bylaws, Article V, Sections 2(a) and 5(c).

<sup>124</sup> The Appeals Committee will consist of two Independent Directors and one Exchange Member Director. See Exchanges Amended and Restated Bylaws, Article V, Section 5(d).

<sup>125</sup> See Exchanges Amended and Restated Bylaws, Article VI, Sections 1 and 2, and Section II.D.1., *supra*.

<sup>126</sup> See Exchanges Amended and Restated Bylaws, Article VI, Sections 1 and 3, and Section II.D.1., *supra*.

<sup>127</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>128</sup> *Id.* See also Section 19(g) of the Act, 15 U.S.C. 78s(g).

<sup>129</sup> See Exchange Rules 2.3(a) and 2.5(a)(4).

<sup>130</sup> *Id.*

<sup>131</sup> See Exchange Rule 2.4. The BATS Exchange also provided a waive-in application process. See BATS Rule 2.4.

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> See Exchange Rule 2.6.

<sup>135</sup> See Exchange Rule 2.6(b).

<sup>136</sup> See Exchange Rule 2.6(c).

<sup>137</sup> See Exchange Rule 2.6(d).

<sup>138</sup> See Exchange Rule 2.7; see also Exchange Rules Chapters VII and VIII.

<sup>139</sup> See Exchange Rule 10.3; see also Exchanges Amended and Restated Bylaws Article V, Section 5(d).

<sup>140</sup> See Exchange Rule 10.4(d).

<sup>141</sup> See Exchange Rule 10.5(a).

<sup>142</sup> *Id.*

<sup>143</sup> See Exchange Rule 10.5(b).

<sup>144</sup> *Id.* Membership decisions are subject to review by the Commission. See Exchange Rule 10.7 and Section 19(d) of the Act, 15 U.S.C. 78s(d).

<sup>145</sup> In its comment letter, Nasdaq states that EDGX and EDGA should be required to amend their rules governing the registration of associated persons of members to address certain deficiencies. See Nasdaq Letter, *supra* note 4, at 7. EDGX and EDGA have revised their member registration rules accordingly. See Exchange Rule 2.3 and Amendment No. 2.

<sup>146</sup> 15 U.S.C. 78f.

<sup>147</sup> 15 U.S.C. 78f(b)(2).

<sup>148</sup> See Nasdaq Exchange Registration Order, *supra* note 75.

## 2. Regulatory Independence

Each Exchange has proposed several measures to help ensure the independence of its regulatory function from its market operations and other commercial interests. The regulatory operations of each Exchange will be supervised by the Exchange's CRO and monitored by its Regulatory Oversight Committee.<sup>149</sup> The Regulatory Oversight Committees of each Exchange will consist of three members, each of whom must be an Independent Director.<sup>150</sup> Each Exchange's Regulatory Oversight Committee will be responsible for monitoring the adequacy and effectiveness of the Exchange's regulatory program, assessing the Exchange's regulatory performance, and assisting the Exchange Board in reviewing the Exchange's regulatory plan and the overall effectiveness of the Exchange's regulatory functions.<sup>151</sup> Each Exchange's Regulatory Oversight Committee also will meet with the Exchange's CRO in executive session at regularly scheduled meetings and at any time upon request of the CRO or any member of the Regulatory Oversight Committee.<sup>152</sup>

Each Exchange proposes that its CRO have general supervision of the regulatory operations of the Exchange, including overseeing surveillance, examination, and enforcement functions.<sup>153</sup> The CRO also will administer any regulatory services agreement with another SRO to which the Exchange is a party.<sup>154</sup> The CRO of each Exchange will be an Executive Vice President or Senior Vice President of the Exchange, and also may serve as the Exchange's General Counsel.<sup>155</sup>

In addition, each Exchange has taken steps designed to provide sufficient funding for the Exchange to carry out its responsibilities under the Act. Specifically, each Exchange has represented that: (1) DE Holdings will allocate sufficient operational assets and make a capital contribution to the Exchange's capital account prior to the launch of the Exchange; (2) such an allocation and contribution will be adequate to operate the Exchange, including the regulation of the Exchange; and (3) there will be an

explicit agreement between the Exchange and DE Holdings that requires DE Holdings to provide adequate funding for each Exchange's operations, including the regulation of the Exchange.<sup>156</sup> In addition, the Amended and Restated Bylaws of each Exchange provides that revenues received by the Exchange from fees derived from its regulatory function or regulatory penalties will not be used for non-regulatory purposes or distributed to the stockholders, but rather, will be applied to fund the legal and regulatory operations of the Exchange (including surveillance and enforcement activities), or will be used to pay restitution and disgorgement of funds intended for customers.<sup>157</sup>

## 3. Regulatory Contracts

Although the Exchanges will be SROs with all of the attendant regulatory obligations under the Act, EDGX and EDGA each have stated that they entered into a regulatory contract with FINRA and a regulatory contract with ISE LLC (each, a "Regulatory Contract," and, together, the "Regulatory Contracts"), under which FINRA and ISE will perform certain regulatory functions on behalf of EDGX and EDGA.<sup>158</sup> Specifically, each Exchange states that FINRA will assist Exchange staff on registration issues on an as-needed basis, investigate potential violations of each Exchange's rules or federal securities laws related to activity on the Exchange, conduct examinations related to market conduct on the Exchange by Members, assist the Exchanges with disciplinary proceedings pursuant to each Exchange's rules, including issuing charges and conducting hearings, and provide dispute resolution services to Exchange Members on behalf of the Exchanges, including operation of each Exchange's arbitration program. Each Exchange also represents that FINRA will provide the Exchange with access to FINRA's WebCRD system, and will assist with programming Exchange-specific functionality relating to such system.<sup>159</sup> With respect to the Regulatory Contracts with ISE, each Exchange states that ISE will perform surveillance including, but not limited to, reviews respecting trading through

protected quotes, locked and crossed markets, manipulation, wash trades, marking the close, customer complaints, frontrunning, trading ahead of customer orders, and anti-spoofing.<sup>160</sup> Notwithstanding the Regulatory Contracts, each Exchange acknowledges it will retain ultimate legal responsibility for the regulation of its members and its market.<sup>161</sup>

The Commission believes that it is consistent with the Act to allow the Exchanges to contract with FINRA and ISE to perform examination, enforcement, and disciplinary functions.<sup>162</sup> These functions are fundamental elements to a regulatory program, and constitute core self-regulatory functions. The Commission believes that FINRA and ISE have the expertise and experience to perform these functions on behalf of the Exchanges.<sup>163</sup>

At the same time, each Exchange, unless relieved by the Commission of its responsibility,<sup>164</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 the Exchange's behalf. In performing these regulatory functions, however, the SROs retained to perform regulatory functions may nonetheless bear liability for causing or aiding and abetting the failure of EDGX or EDGA to perform its

<sup>160</sup> Each Exchange also states that ISE surveillance will work closely with the market operations and legal/compliance groups of the Exchange, when needed, to perform error trade reviews. See Amendment No. 2, *supra* note 5.

<sup>161</sup> See Exchange Rule 13.7 and Amendment No. 2, *supra* note 5.

<sup>162</sup> See, e.g., Regulation ATS Release, *supra* note 117. 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) ("Amex Regulatory Services Approval Order"); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (SR-NASDAQ-2007-004) ("NOM Approval Order"); Nasdaq Exchange Registration Order, *supra* note 75; and BATS Exchange Order, *supra* note 65.

<sup>163</sup> See, e.g., Amex Regulatory Services Approval Order, *supra* note 162; NOM Approval Order, *supra* note 162; and Nasdaq Exchange Registration Order, *supra* note 75. The Commission notes that the Regulatory Contracts are not before the Commission and, therefore, the Commission is not acting on them.

<sup>164</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. See also Section III.E.4, *infra*.

<sup>149</sup> See Exchanges Amended and Restated Bylaws, Article V, Section 5(c).

<sup>150</sup> See Exchanges Amended and Restated Bylaws Articles I(u) and V, Sections 2(a) and 5(c).

<sup>151</sup> See Exchanges Amended and Restated Bylaws Article V, Section 5(c).

<sup>152</sup> See Exchanges Amended and Restated Bylaws Article VII, Section 9.

<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* See Nasdaq Exchange Registration Order, *supra* note 75.

<sup>156</sup> See Amendment No. 2, *supra* note 5.

<sup>157</sup> See Exchanges Amended and Restated Bylaws Article X, Section 4.

<sup>158</sup> See Exchange Rule 13.7; see also Amendment No. 2. Pursuant to the applicable provisions of the Freedom of Information Act, 5 U.S.C. 552, and Commission regulations thereunder, 17 CFR 200.83, the Exchanges have requested confidential treatment for the Regulatory Contracts.

<sup>159</sup> See Amendment No. 2, *supra* note 5.

regulatory functions.<sup>165</sup> Accordingly, although FINRA and ISE will not act on their own behalf under their SRO responsibilities in carrying out these regulatory services for the Exchanges, as SROs retain to perform regulatory functions, they 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 EDGX or EDGA.<sup>166</sup>

Because the exhibits to the Regulatory Contracts, including the Exchange and Commission rules covered by the Regulatory Contracts, have not yet been finalized, the Commission is conditioning the operation of EDGX and EDGA as exchanges on the finalization of the provisions in the Regulatory Contracts that will specify the Exchange and Commission rules for which FINRA and ISE will provide regulatory functions.<sup>167</sup>

#### 4. 17d–2 Agreement

Section 19(g)(1) of the Act<sup>168</sup> 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.<sup>169</sup> Section 17(d) was intended, in part, to eliminate unnecessary multiple examinations and regulatory duplication with respect to members of more than one SRO ("common members").<sup>170</sup> Rule 17d–2 of the Act permits SROs to propose joint plans allocating regulatory responsibilities concerning common members.<sup>171</sup> These agreements, which must be filed with and approved by the Commission, generally cover such regulatory functions as personnel registration, branch office examinations,

and sales practices. Commission approval of a Rule 17d–2 plan relieves the specified SRO of those regulatory responsibilities allocated by the plan to another SRO.<sup>172</sup> Many existing SROs have entered into such agreements.<sup>173</sup>

EDGX and EDGA each have represented to the Commission that each Exchange and FINRA intend to file Rule 17d–2 agreements with the Commission covering common members of EDGX or EDGA, as applicable, and FINRA. These agreements would allocate to FINRA regulatory responsibility, with respect to common members, for the following:

- FINRA will examine common members of EDGX or EDGA, as applicable, and FINRA for compliance with federal securities laws, rules and regulations, and rules of the Exchange that the Exchange has certified as identical or substantially similar to FINRA rules.
- FINRA will investigate common members of EDGX or EDGA, as applicable, and FINRA for violations of federal securities laws, rules or regulations, or Exchange rules that the Exchange has certified as identical or substantially identical to a FINRA rule.
- FINRA will enforce compliance by common members with the federal securities laws, rules and regulations, and the rules of EDGX or EDGA, as applicable, that the Exchange has certified as identical or substantially similar to FINRA rules.

Because EDGX and EDGA anticipate entering into this Rule 17d–2 agreement, they have not made provision to fulfill the regulatory obligations that would be undertaken by FINRA under these agreements with respect to common members of EDGX or EDGA, as applicable, and FINRA.<sup>174</sup> Accordingly, the Commission is conditioning the operation of the Exchanges on approval by the Commission of the Rule 17d–2

agreements between each Exchange and FINRA that allocate the above specified matters to FINRA.<sup>175</sup>

#### 5. Discipline and Oversight of Members

As noted above, as a prerequisite for Commission approval of an exchange's application for registration, an exchange must be organized and have the capacity to carry out the purposes of the Act. Among other requirements, an exchange must be able to enforce compliance by its members and persons associated with its members with federal securities laws and the rules of the exchange.<sup>176</sup> As noted above, pursuant to the Regulatory Contracts, FINRA will perform many of the initial disciplinary processes on behalf of the Exchanges.<sup>177</sup> For example, FINRA will investigate potential securities laws violations, issue complaints, and conduct hearings pursuant to the rules of the Exchanges. Appeals from disciplinary decisions will be heard by each Exchange's Appeals Committee,<sup>178</sup> and the Appeals Committee's decision shall be final. In addition, each Exchange Board may on its own initiative order review of a disciplinary decision.<sup>179</sup>

The Exchanges Amended and Restated Bylaws and the Exchanges' rules provide that each Exchange has disciplinary jurisdiction over its members so that it can enforce its members' compliance with its rules and the federal securities laws.<sup>180</sup> Each Exchange's rules also permit it to sanction members for violations of its rules and violations of the federal securities laws and rules by, among other things, expelling or suspending members, limiting members' activities, functions, or operations, fining or censuring members, or suspending or barring a person from being associated with a member, or any other fitting sanction.<sup>181</sup> Each Exchange's rules also provide for the imposition of fines for certain minor rule violations in lieu of commencing disciplinary proceedings.<sup>182</sup> Accordingly, as a condition to the operation of the Exchanges, a Minor Rule Violation Plan ("MRVP") filed by each Exchange under

<sup>165</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 would 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.*, Nasdaq Exchange Registration Order, *supra* note 75; BATS Exchange Order, *supra* note 65; and Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (File No. 10–127) (order approving the International Securities Exchange LLC's application for registration as a national securities exchange).

<sup>166</sup> *Id.*

<sup>167</sup> Alternatively, the Exchanges could demonstrate that they have the ability to fulfill their regulatory obligations.

<sup>168</sup> 15 U.S.C. 78s(g)(1).

<sup>169</sup> 15 U.S.C. 78q(d).

<sup>170</sup> *See* Securities Exchange Act Release No. 12935 (October 28, 1976), 41 FR 49091 (November 8, 1976) ("Rule 17d–2 Adopting Release").

<sup>171</sup> 17 CFR 240.17d–2.

<sup>172</sup> *See* Rule 17d–2 Adopting Release, *supra* note 170.

<sup>173</sup> *See, e.g.*, Securities Exchange Act Release Nos. 13326 (March 3, 1977), 42 FR 13878 (March 14, 1977) (NYSE/Amex); 13536 (May 12, 1977), 42 FR 26264 (May 23, 1977) (NYSE/BSE); 14152 (November 9, 1977), 42 FR 59339 (November 16, 1977) (NYSE/CSE); 13535 (May 12, 1977), 42 FR 26269 (May 23, 1977) (NYSE/CHX); 13531 (May 12, 1977), 42 FR 26273 (May 23, 1977) (NYSE/PSE); 14093 (October 25, 1977), 42 FR 57199 (November 1, 1977) (NYSE/Phlx); 15191 (September 26, 1978), 43 FR 46093 (October 5, 1978) (NASDAQ/BSE, CSE, CHX and PSE); 16858 (May 30, 1980), 45 FR 37927 (June 5, 1980) (NASDAQ/BSE, CSE, CHX and PSE); 42815 (May 23, 2000), 65 FR 34762 (May 31, 2000) (NASDAQ/ISE); and 54136 (July 12, 2006), 71 FR 40759 (July 18, 2006) (NASDAQ/Nasdaq).

<sup>174</sup> The Commission notes that regulation that is to be covered by the Rule 17d–2 agreements for common members will be carried out by FINRA under the Regulatory Contracts for EDGX or EDGA members that are not also members of FINRA.

<sup>175</sup> Alternatively, EDGX and EDGA could demonstrate that they have the ability to fulfill their regulatory obligations.

<sup>176</sup> *See* 15 U.S.C. 78f(b)(1).

<sup>177</sup> *See* Section III.E.5, *supra*.

<sup>178</sup> *See* Exchange Rule 8.10(b).

<sup>179</sup> *See* Exchange Rule 8.10(c).

<sup>180</sup> *See generally* Exchanges Amended and Restated Bylaws Article X and Exchange Rules Chapters II and VIII.

<sup>181</sup> *See* Exchange Rules 2.2 and 8.1(a).

<sup>182</sup> *See* Exchange Rule 8.15.

Act Rule 19d-1(c)(2) must be declared effective by the Commission.<sup>183</sup>

The Commission finds that the Exchanges Amended and Restated By-Laws and the rules of each Exchange concerning the Exchange's disciplinary and oversight programs are consistent with the requirements of sections 6(b)(6) and 6(b)(7)<sup>184</sup> of the Act in that they provide fair procedures for the disciplining of members and persons associated with members. The Commission further finds that the rules of EDGX and EDGA are designed to provide the Exchanges with the ability to comply, and with the authority to enforce compliance by their members and persons associated with their members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchanges.<sup>185</sup>

#### F. Trading Systems of EDGX and EDGA

##### 1. Trading Rules

Each Exchange will operate a fully automated electronic order book. Members of EDGX and EDGA and entities that enter into sponsorship arrangements with such members (collectively, "Users") will have access to the systems of EDGX and EDGA (each, an "EDGX System," an "EDGA System," or an "Exchange System," and, together, the "Exchange Systems").<sup>186</sup> Users will be able to electronically submit market and various types of limit orders to EDGX or EDGA from remote locations.<sup>187</sup> All orders submitted to the

Exchanges will be displayed unless designated otherwise by the Exchange member submitting the order. Displayed orders will be displayed on an anonymous basis at a specified price. Non-displayed orders will not be displayed but will be ranked in an Exchange System at a specified price.<sup>188</sup> The Exchanges' Systems will continuously and automatically match orders pursuant to price/time priority, except that displayed orders will have priority over non-displayed orders at the same price.<sup>189</sup>

Each Exchange System is designed to comply with Rule 611 of Regulation NMS<sup>190</sup> by requiring that, for any execution to occur on the Exchange during regular trading hours, the price must be equal to, or better than, any "protected quotation" within the meaning of Regulation NMS ("Protected Quotation"), unless an exception to Rule 611 of Regulation NMS applies.<sup>191</sup> Each Exchange will direct any orders or portion of orders that cannot be executed in their entirety to away markets for execution, unless the terms of the orders direct the Exchange not to route such orders away.<sup>192</sup>

Each Exchange intends to operate as an automated trading center in compliance with Rule 600(b)(4) of Regulation NMS.<sup>193</sup> Each Exchange will display automated quotations at all times except in the event that a systems malfunction renders the Exchange's System incapable of displaying automated quotations.<sup>194</sup> Each Exchange has designed its rules relating to orders, modifiers, and order execution to comply with the requirements of Regulation NMS, including an immediate-or-cancel functionality.<sup>195</sup> These rules include accepting orders marked as intermarket sweep orders, which will allow orders so designated to be automatically matched and executed without reference to Protected Quotations at other trading centers,<sup>196</sup> and routing orders marked as intermarket sweep orders by a User to a specific trading center for

execution.<sup>197</sup> In addition, each Exchange's rules address locked and crossed markets,<sup>198</sup> as required by Rule 610(d) of Regulation NMS.<sup>199</sup> The Commission believes that the Exchanges' rules are consistent with the Act, in particular with the requirements of Rule 610(d) and Rule 611 of Regulation NMS.

As stated above, each Exchange intends to operate as an automated trading center and have its best bid and best offer be a Protected Quotation.<sup>200</sup> To meet their regulatory responsibilities under Rule 611(a) of Regulation NMS, market participants must have sufficient notice of new Protected Quotations, as well as all necessary information (such as final technical specifications).<sup>201</sup> Therefore, the Commission believes that it would be a reasonable policy and procedure under Rule 611(a) for industry participants to begin treating each Exchange's best bid and best offer as a Protected Quotation within 90 days after the date of this order, or such later date as the Exchange begins operations as national securities exchange.

##### 2. Section 11 of the Act

Section 11(a)(1) of the Act<sup>202</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 discretion (collectively, "covered accounts"), unless an exception applies. Rule 11a2-2(T) under the Act,<sup>203</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) Must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;<sup>204</sup> (iii) may not be affiliated with the executing

<sup>183</sup> 17 CFR 240.19d-1(c)(2).

<sup>184</sup> 15 U.S.C. 78f(b)(6) and (b)(7).

<sup>185</sup> See Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1).

<sup>186</sup> To obtain authorized access to the Exchange Systems, each User must enter into a User Agreement with the Exchange(s). See Exchange Rule 11.3(a).

<sup>187</sup> One proposed order type is the Step-up Order, which is a market or limit order with the instruction that the Exchange System display the order to Users at or within the National Best Bid or Offer ("NBBO") price pursuant to Exchange Rule 11.9(b)(1)(C). See Exchange Rule 11.5(c)(11). Prior to routing to away markets, or cancellation per the order's instructions, Step-up Orders will be displayed to Users, in a manner that is separately identifiable from other Exchange orders, at or within the NBBO price for a period of time not to exceed 500 milliseconds, as determined by the Exchange. See Exchange Rule 11.9(a)(1)(C). In its comment letter, Nasdaq notes that the Commission recently has proposed a rule amendment to prohibit the use of this type of order, known as a flash order, and questions whether the Commission should approve the Form 1 Applications with an order type that "would become illegal if the Commission's flash order ban is adopted." See Nasdaq Letter, *supra* note 4, at 6. The Commission notes that it has not acted on its proposal to prohibit the use of flash orders. The Commission also notes that the Exchanges will be required to comply with any Commission rules regarding flash orders and that the Exchanges have represented that they will do so. See letter from William O'Brien, Chief Executive

Officer, DE Holdings, DECN, EDGX, and EDGA, to James Brigagliano, Co-Acting Director, Division of Trading and Markets, Commission, dated August 10, 2009.

<sup>188</sup> The rules of EDGX and EDGA do not provide for specialists or market makers.

<sup>189</sup> See Exchange Rule 11.8.

<sup>190</sup> 17 CFR 242.611.

<sup>191</sup> See Exchange Rule 11.9(a).

<sup>192</sup> See Exchange Rule 11.9(b)(2).

<sup>193</sup> 17 CFR 242.600(b)(4).

<sup>194</sup> See Exchange Rule 11.9(d); see also 17 CFR 242.600(b)(3).

<sup>195</sup> See Exchange Rules 11.5 and 11.9; see also 17 CFR 242.600(b)(3).

<sup>196</sup> See Exchange Rule 11.5(d)(1).

<sup>197</sup> See Exchange Rule 11.5(d)(2).

<sup>198</sup> See Exchange Rule 11.16.

<sup>199</sup> 17 CFR 242.610(d).

<sup>200</sup> 17 CFR 242.600(b)(58).

<sup>201</sup> See Securities Exchange Act Release No. 53829 (May 18, 2006), 71 FR 30038, 30041 (May 24, 2006).

<sup>202</sup> 15 U.S.C. 78k(a)(1).

<sup>203</sup> 17 CFR 240.11a2-2(T).

<sup>204</sup> The member may, however, participate in clearing and settling the transaction. See 1978 Release, *infra* note 206.

member; and (iv) with respect to an account over which the member 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.

In letters to the Commission,<sup>205</sup> each Exchange requested that the Commission concur with its conclusion that Exchange members entering orders into each respective Exchange System satisfy the requirements of Rule 11a2-2(T). For the reasons set forth below, the Commission believes that EDGA members entering orders into the EDGA System and EDGX members entering orders into the EDGX System would satisfy the conditions of the Rule.

The rule's first condition is that orders for covered accounts be transmitted from off the exchange floor. Each Exchange System receives 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>206</sup> Because each Exchange System receives orders electronically through remote terminals or computer-to-computer interfaces, the Commission believes that each System satisfies the off-floor transmission requirement.

Second, the rule requires that the member not participate in the execution of its order. Each Exchange represents

that at no time following the submission of an order is a member able to acquire control or influence over the result or timing of an order's execution.<sup>207</sup> According to each Exchange, the execution of a member's order is determined solely by what orders, bids, or offers are present in each system at the time the member submits the order and on the priority of those orders, bids and offers.<sup>208</sup> Accordingly, the Commission believes that Exchange members do not participate in the execution of orders submitted into the Exchange Systems.

Third, Rule 11a2-2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that this requirement is satisfied when automated exchange facilities, such as the Exchange Systems, are used, as long as 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.<sup>209</sup> Each Exchange represents that the design of its Exchange System ensures that no member has any special or unique trading advantage in the handling of its orders after transmitting its orders to the Exchange.<sup>210</sup> Based on the Exchanges' representations, the Commission believes that the Exchange Systems satisfy this requirement.

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>211</sup> Each Exchange represents that Exchange members trading for covered accounts over which they exercise investment discretion must comply with this condition in order to rely on the rule's exemption.<sup>212</sup>

#### G. Section 11A of the Act

Section 11A of the Act and the rules thereunder form the basis of our national market system and impose requirements on exchanges to implement its objectives. Specifically, national securities exchanges are required, under Rule 601 of Regulation NMS,<sup>213</sup> to file transaction reporting plans regarding transactions in listed equity and Nasdaq securities that are executed on their facilities. Currently registered exchanges satisfy this requirement by participating in the Consolidated Transaction Association Plan ("CTA Plan") for listed equities and the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("Nasdaq UTP Plan") for Nasdaq securities.<sup>214</sup> Before the Exchanges can begin operating as exchanges, each must join these plans as a participant.

National securities exchanges are required, under Rule 602 of Regulation

<sup>205</sup> See letter from Eric W. Hess, General Counsel and Secretary, EDGA Exchange, to Elizabeth Murphy, Secretary, Commission, dated February 11, 2010; and letter from Eric W. Hess, General Counsel and Secretary, EDGX Exchange, to Elizabeth Murphy, Secretary, Commission, dated February 11, 2010 (collectively, "Exchange 11(a) Request Letters").

<sup>206</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 NASDAQ OMX BX); 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004) (order approving the Boston Options Exchange as an options trading facility of the Boston Stock Exchange); 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (order approving Archipelago Exchange as electronic trading facility of the Pacific Exchange ("PCX")); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (regarding NYSE's Off-Hours Trading Facility); 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) (regarding the American Stock Exchange ("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 ("Phlx") Automated Communications and Execution System ("1979 Release")); and 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (regarding the NYSE's Designated Order Turnaround System ("1978 Release")).

<sup>207</sup> See Exchange 11(a) Request Letters, *supra* note 205. The member may only cancel or modify the order, or modify the instructions for executing the order, but only from off the Exchange floor. 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 1978 Release, *supra* note 206 (stating that the "non-participation requirement 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>208</sup> *Id.*

<sup>209</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 1979 Release, *supra* note 206.

<sup>210</sup> See Exchange 11(a) Request Letters, *supra* note 205.

<sup>211</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 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 206 (stating "[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

<sup>212</sup> See Exchange 11(a) Request Letters, *supra* note 205.

<sup>213</sup> 17 CFR 242.601.

<sup>214</sup> These plans also satisfy the requirement in Rule 603 that national securities exchanges and national securities associations act jointly pursuant to an effective national market system plan to disseminate consolidated information, including a national best bid and offer, and quotations for and transactions in NMS stocks. See 17 CFR 242.603. See also Nasdaq Exchange Registration Order, *supra* note 75.



NMS,<sup>215</sup> to collect bids, offers, quotation sizes and aggregate quotation sizes from those members who are responsible broker or dealers. National securities exchanges must then make this information available to vendors at all times when the exchange is open for trading. The current exchanges satisfy this requirement by participating in the Consolidated Quotation System Plan ("CQ Plan") for listed equity securities and the Nasdaq UTP Plan for Nasdaq securities. Before EDGX and EDGA can begin operating as exchanges, each must join the CQ Plan as a participant, in addition to the CTA Plan and the Nasdaq UTP Plan.

Finally, national securities exchanges must make available certain order execution information pursuant to Rule 605 of Regulation NMS.<sup>216</sup> Current exchanges have standardized the required disclosure mechanisms by participating in the Order Execution Quality Disclosure Plan.<sup>217</sup> Each Exchange must join this plan before it begins operations as an exchange.

#### H. Order Routing

As discussed above, DE Holdings wholly owns EDGA, EDGX, and DECN.<sup>218</sup> As such, each Exchange is affiliated with DECN,<sup>219</sup> which is a registered broker-dealer and member of FINRA. The Exchanges also anticipate that DECN will be a member of each Exchange.

Each Exchange's Rule 2.10 provides generally that, without prior Commission approval, the Exchange may not, directly or indirectly, acquire or maintain an ownership interest in a member organization of such Exchange. In addition, each Exchange's Rule 2.10 provides that, without prior Commission approval, none of the Exchange's members may be or become an affiliate of the Exchange or an affiliate of an affiliate of the Exchange. However, each Exchange proposes that its affiliate, DECN, become a member of the Exchange to provide certain routing services on behalf of the Exchange. Specifically, each Exchange proposes to (1) operate DECN as a facility of such Exchange to provide outbound routing services to other securities exchanges,<sup>220</sup> automated trading

systems, electronic communications networks, or other broker-dealers (collectively, "Trading Centers"), and (2) receive through DECN orders routed inbound to such Exchange from its affiliated exchange (*i.e.*, EDGX in the case of EDGA, and EDGA in the case of EDGX).<sup>221</sup> Accordingly, each Exchange seeks Commission approval of an exception in the Exchange's Rule 2.10 that will permit the affiliation between the Exchange and its member, DECN.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange, particularly where a member is routing orders to such affiliated exchange,<sup>222</sup> each Exchange has proposed limitations and conditions on DECN's affiliation with the Exchange. Specifically, each Exchange proposes that DECN operate as an affiliated outbound router on behalf of the Exchange, subject to certain conditions set forth in the Exchange's Rule 2.11; and that DECN operate as an affiliated inbound router on behalf of the Exchange subject to certain conditions set forth in the Exchange's Rule 2.12.<sup>223</sup>

#### 1. DECN as Outbound Router

Each Exchange proposes that DECN would operate as a facility of the Exchange providing outbound routing services from the Exchange to other Trading Centers.<sup>224</sup> DECN's operation as a facility providing outbound routing services for each Exchange is subject to the conditions that:

- The Exchange regulates DECN as a facility of the Exchange;
- FINRA, a self-regulatory organization unaffiliated with the Exchange, is DECN's designated examining authority;
- DECN only provides routing services unless otherwise approved by the Commission;
- The use of DECN for outbound routing by Exchange members is optional; and
- The Exchange will establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the Exchange and its facilities (including DECN) and any other entity.<sup>225</sup>

<sup>221</sup> See Notice, *supra* note 3.

<sup>222</sup> See *e.g.*, Securities Exchange Act Release No. 53382 (February 27, 2006), 71 FR 11251 FR (March 6, 2006).

<sup>223</sup> See Exchange Rules 2.11 and 2.12.

<sup>224</sup> See Exchange Rule 2.11. See also Notice, *supra* note 3.

<sup>225</sup> *Id.*

As a facility of each Exchange, DECN will be subject to each Exchange's and the Commission's regulatory oversight; and each Exchange will be responsible for ensuring that DECN's outbound routing function is operated consistent with section 6 of the Act and the Exchange's rules. In addition, each Exchange will be required to file with the Commission rule changes and fees relating to DECN's outbound routing function. Any such fees relating to DECN's outbound router function will be subject to exchange non-discrimination requirements. Further, the Commission believes that the proposed conditions on which DECN will operate as a facility providing outbound routing services for each Exchange should minimize the potential for conflicts of interest and informational advantages involved where a member firm is affiliated with an exchange to which it is routing orders. The Commission notes that the proposed conditions for the operation of DECN as affiliated outbound router on behalf of each Exchange are consistent with conditions the Commission has approved for other exchanges.<sup>226</sup> The Commission therefore finds the proposed operation of DECN as an affiliated outbound router of each Exchange to be consistent with the Act.

#### 2. DECN as Inbound Router

Each Exchange also proposes that DECN, operating as a facility of the Exchange, provide routing services from EDGX to EDGA, in the case of EDGA, and from EDGA to EDGX, in the case of EDGX (*i.e.*, "inbound" routing), subject to the following conditions and limitations:

- The Exchange enters into (1) a 17d-2 agreement with FINRA, a non-affiliated SRO,<sup>227</sup> to relieve the Exchange of regulatory responsibilities for DECN with respect to rules that are common rules between the Exchange and the non-affiliated SRO, and (2) a regulatory services agreement with FINRA, a non-affiliated SRO, to perform regulatory responsibilities for DECN for unique Exchange rules.
- The regulatory service agreement requires the Exchange to provide the non-affiliated SRO with information, in an easily accessible manner, regarding all exception reports, alerts, complaints, trading errors, cancellations, investigations, and enforcement matters

<sup>226</sup> See, *e.g.*, Securities Exchange Act Release No. 59153 (December 23, 2008), 73 FR 80485 (December 31, 2008) (order approving outbound routing by broker-dealer affiliate of Nasdaq Stock Exchange); and BATS Exchange Order, *supra* note 65.

<sup>227</sup> The Rule 17d-2 agreement is discussed at Section III.E.4, *supra*.

<sup>215</sup> 17 CFR 242.602.

<sup>216</sup> 17 CFR 242.605.

<sup>217</sup> See Securities Exchange Act Release No. 44177 (April 12, 2001), 66 FR 19814 (April 17, 2001).

<sup>218</sup> See Section III.A, *supra*.

<sup>219</sup> The Exchanges state that DECN will do business under the name of "DE Route."

<sup>220</sup> Securities exchanges to which each Exchange proposes to route orders include its affiliated exchange (*i.e.*, EDGX in the case of EDGA, and EDGA in the case of EDGX).

(collectively "Exceptions") in which DECN is identified as a participant that has potentially violated Exchange or Commission Rules, and requires that FINRA provide a report, at least quarterly, to the Exchange quantifying all Exceptions in which DECN is identified as a participant that has potentially violated Exchange or Commission rules.

- The Exchange has in place a rule that requires DE Holdings to establish and maintain procedures and internal controls reasonably designed to ensure that DECN does not develop or implement changes to its system based on non-public information obtained as a result of its affiliation with the Exchange, until such information is available generally to similarly situated members of the Exchange.

- Routing of orders from DECN to the Exchange, in DECN's capacity as a facility of the affiliated exchange (*i.e.*, EDGX, in the case of EDGA, and EDGA, in the case of EDGX), be authorized for a pilot period of 12 months.<sup>228</sup>

Although the Commission continues to be concerned about potential unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit DECN to be affiliated with each Exchange and to provide inbound routing to each Exchange on a pilot basis, subject to the conditions described above.

Each Exchange has proposed five conditions applicable to DECN's inbound routing activities, which are enumerated above. The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that FINRA's oversight of DECN,<sup>229</sup> combined with FINRA's monitoring of DECN's compliance with the equity trading rules and quarterly reporting to each Exchange, will help to protect the independence of each Exchange's regulatory responsibilities with respect to DECN. The Commission also believes that the requirement that each Exchange establish and maintain procedures and internal controls reasonably designed to ensure that DECN does not develop or implement changes to its system based on non-public information obtained as a result of its affiliation with the

Exchange, until such information is available generally to similarly situated members of the Exchange is reasonably designed to ensure that DECN cannot use any information advantage it may have because of its affiliation with the Exchange. Furthermore, the Commission believes that each Exchange's proposal to allow DECN to route orders inbound to its affiliated exchange (*i.e.*, from EDGX, in the case of EDGA, and from EDGA, in the case of EDGX), on a pilot basis, will provide each Exchange and the Commission an opportunity to assess the impact of any conflicts of interest of allowing an affiliated member of an Exchange to route orders inbound to the Exchange and whether such affiliation provides an unfair competitive advantage.

Further, the Commission notes that the proposed conditions for the operation of DECN as affiliated inbound router on behalf of each Exchange are similar to conditions the Commission has approved for other exchanges.<sup>230</sup> The Commission therefore finds the proposed operation of DECN as an affiliated inbound router of each Exchange is consistent with the Act.

#### *I. Listing Requirements/Unlisted Trading Privileges*

The Exchanges initially do not intend to list any securities. Accordingly, the Exchanges have not proposed rules that would allow them to list any securities at this time.<sup>231</sup> Instead, the Exchanges have proposed to trade securities pursuant to unlisted trading privileges, consistent with section 12(f) of the Act and Rule 12f-5 thereunder. Rule 12f-5 requires an exchange that extends unlisted trading privileges to securities to have in effect a rule or rules providing for transactions in the class or type of security to which the exchange extends unlisted trading privileges.<sup>232</sup> Each Exchange's rules allow it to extend

unlisted trading privileges to any security listed on another national securities exchange or with respect to which unlisted trading privileges may otherwise be extended in accordance with section 12(f) of the Act.<sup>233</sup> Each Exchange's rules provide for transactions in the class or type of security to which the exchange intends to extend unlisted trading privileges.<sup>234</sup> In addition, pursuant to its rules, each Exchange will cease trading any equity security admitted to unlisted trading privileges that is no longer listed on another national securities exchange or to which unlisted trading privileges may no longer be extended, consistent with Section 12(f). The Commission finds that these rules are consistent with the Act.<sup>235</sup>

#### *J. Exchange Fees*

In the Form 1 Applications, the Exchanges generally describes their proposed fees and note that they, may, in the future, prescribe such reasonable dues, fees, and assessments or other charges as they may deem appropriate.<sup>236</sup> Nasdaq, however, argues that the Form 1 Applications are deficient because the Exchanges have not included their fee schedules in the Form 1 Applications.<sup>237</sup> The Commission notes that it previously approved Form 1 applications that did not include fee schedules. For example, the Commission approved the Form 1 application of BATS Exchange, Inc. ("BATS") on August 18, 2008,<sup>238</sup> and BATS subsequently filed its fee schedule on October 21, 2008, pursuant to Exchange Act Section 19(b).<sup>239</sup> The

<sup>233</sup> See Exchange Rule 14.1(a).

<sup>234</sup> *Id.* The Exchanges' rules currently do not provide for the trading of options, security futures, or other similar instruments.

<sup>235</sup> Each Exchange has represented to the Commission that it intends to phase-in the trading of securities currently trading on the DECN to each Exchange, and that it will provide appropriate advance notice to its members of the phase-in schedule. The Commission believes that this approach is appropriate and should help maintain an orderly transition to the Exchanges. See Amendment No. 2, *supra* note 5.

<sup>236</sup> See Form 1 Applications, Exhibit E, Response F.

<sup>237</sup> See Nasdaq Letter, *supra* note 4, at 7-8. Nasdaq also raises questions concerning fees that Nasdaq proposed in File No. SR-NASDAQ-2009-054. See Nasdaq Letter, *supra* note 4, at 8. The Commission believes that Nasdaq's proposed fees should be addressed in the context of Nasdaq's proposal, rather than in connection with the Form 1 Applications.

<sup>238</sup> See BATS Exchange Order, *supra* note 65.

<sup>239</sup> See Securities Exchange Act Release No. 58871 (October 28, 2008), 73 FR 65428 (November 3, 2008) (notice of filing and immediate effectiveness of File No. SR-BATS-2008-009) (implementing the fee schedule that would be in effect on the date BATS commenced operations as a national securities exchange). Similarly, DE

<sup>228</sup> See Exchange Rule 2.12.

<sup>229</sup> This oversight will be accomplished through the Rule 17d-2 agreement and the RSA.

<sup>230</sup> See *e.g.*, Securities Exchange Release Nos. 60598 (September 1, 2009), 74 FR 46280 (September 8, 2009) (SR-ISE-2009-45); 59154 (December 23, 2008) 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (order approving proposed rulebook of NASDAQ OMX BX); and 59009 (November 24, 2008), 73 FR 73363 (December 2, 2008) (order granting accelerated approval to File No. SR-NYSEALTR-2008-07).

<sup>231</sup> The Exchanges have incorporated listing standards for certain derivative securities products in their rules. However, each Exchange's rules will prohibit the Exchange from listing any derivative security product pursuant to these listing standards until the Exchange submits a proposed rule change to the Commission to amend its listing standards to comply with Rule 10A-3 under the Act and incorporate qualitative listing criteria. See Exchange Rule 14.1(a).

<sup>232</sup> 17 CFR 240.12f-5. See also Securities Exchange Act Release No. 35737 (April 21, 1995), 60 FR 20891 (April 28, 1995) (adopting Rule 12f-5).

Commission also notes that any fees to be charged by the Exchanges would need to be filed with the Commission pursuant to section 19(b) of the Act and would not be effective until filed with, or filed with and approved by, the Commission.

#### IV. Exemption From Section 19(b) of the Act With Regard to FINRA Rules Incorporated by Reference

Each Exchange proposes to incorporate by reference certain rules of FINRA.<sup>240</sup> Thus, for certain EDGA rules, EDGA members will comply with an EDGA rule by complying with the referenced FINRA rule. Similarly, for certain EDGX rules, EDGX members will comply with an EDGX rule by complying with the referenced FINRA rule.

In connection with its proposal to incorporate FINRA rules by reference, each Exchange requested, pursuant to Rule 240.0–12,<sup>241</sup> an exemption under Section 36 of the Act from the rule filing requirements of Section 19(b) of the Act for changes to those Exchange rules that are effected solely by virtue of a change to a cross-referenced FINRA rule.<sup>242</sup> Each Exchange proposes to incorporate by reference categories of rules (rather than individual rules within a category) that are not trading rules. Each Exchange agrees to provide written notice to its members whenever FINRA proposes a change to a cross-referenced rule<sup>243</sup> and whenever any such proposed changes are approved by the Commission.<sup>244</sup>

Using its authority under Section 36 of the Act, the Commission previously

Holdings notes that Nasdaq filed fee schedules for two of its facilities, Nasdaq BX and the Nasdaq Options Market, after the Commission approved rules establishing the facilities. See DE Holdings Response, *supra* note 4, at 5.

<sup>240</sup> Specifically, each Exchange proposes to incorporate by reference the following FINRA rules: FINRA's 1010 Series (Membership Proceedings) (referenced in each Exchange's Rule 2.4); FINRA's 12,000 Series (Code of Arbitration for Customer Disputes) and FINRA's 13,000 Series (Code of Arbitration Procedure for Industry Disputes) (referenced in each Exchange's Rules 9.1 and 9.4).

<sup>241</sup> 17 CFR 240.0–12.

<sup>242</sup> See letter from Eric W. Hess, General Counsel and Secretary, EDGA, to Elizabeth M. Murphy, Secretary, Commission, dated February 11, 2010; and letter from Eric W. Hess, General Counsel and Secretary, EDGX, to Elizabeth M. Murphy, Secretary, Commission, dated February 11, 2010 (together, the "Exchange 19(b) Exemption Request Letters").

<sup>243</sup> See Exchange 19(b) Exemption Request Letters, *supra* note 242.

<sup>244</sup> Each Exchange will provide such notice through a posting on the same Web site location where each Exchange will post its own rule filings pursuant to Rule 19b–4 under Act, within the time frame required by that Rule. The Web site posting will include a link to the location on the FINRA Web site where FINRA's proposed rule change is posted. *Id.*

exempted certain SROs from the requirement to file proposed rule changes under Section 19(b) of the Act.<sup>245</sup> Each such exempt SRO agreed to be governed by the incorporated rules, as amended from time to time, but is not required to file a separate proposed rule change with the Commission each time the SRO whose rules are incorporated by reference seeks to modify its rules. In addition, each SRO incorporated by reference only regulatory rules (*e.g.*, margin, suitability, arbitration), not trading rules, and incorporated by reference whole categories of rules (*i.e.*, did not "cherry-pick" certain individual rules within a category). Each exempt SRO had reasonable procedures in place to provide written notice to its members each time a change is proposed to the incorporated rules of another SRO in order to provide its members with notice of a proposed rule change that affects their interests, so that they would have an opportunity to comment on it.

The Commission is granting each Exchange'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 each Exchange proposes to incorporate by reference into their respective rules. This exemption is conditioned upon each Exchange providing written notice to its members whenever FINRA proposes to change a rule that each Exchange has incorporated by reference. The Commission believes that this exemption is appropriate in the public interest and consistent with the protection of investors because it will promote more efficient use of Commission and SRO resources by avoiding duplicative rule filings based on simultaneous changes to identical rule text sought by more than one SRO. Consequently, the Commission grants each Exchange's exemption request.

#### V. Conclusion

*It is ordered* that the applications of each of EDGX and EDGA for registration as a national securities exchange be, and hereby is, granted.

*It is further ordered* that operation of each of EDGX and EDGA is conditioned on the satisfaction of the requirements below:

A. *Participation in National Market System Plans.* Each Exchange must join the CTA Plan, the CQ Plan, the Nasdaq

<sup>245</sup> See, *e.g.*, Securities Exchange Act Release No. 57478 (March 12, 2008) 73 FR 14521, (March 18, 2008) (order approving rules governing the trading of options on the NASDAQ Options Market); Nasdaq Exchange Registration Order, *supra* note 75; and BATS Exchange Registration Order, *supra* note 65.

UTP Plan, and the Order Execution Quality Disclosure Plan.

B. *Intermarket Surveillance Group.* Each Exchange must join the Intermarket Surveillance Group.

C. *Minor Rule Violation Plan.* A MRVP filed by each Exchange under Rule 19d–1(c)(2) must be declared effective by the Commission.<sup>246</sup>

D. *17d–2 Agreement.* An agreement pursuant to Rule 17d–2<sup>247</sup> between FINRA and each Exchange that allocates to FINRA regulatory responsibility for those matters specified above<sup>248</sup> must be approved by the Commission, or each Exchange must demonstrate that it independently has the ability to fulfill all of its regulatory obligations.

E. *Regulatory Contracts.* Each Exchange and FINRA, and each Exchange and ISE LLC, must finalize the provisions in the Regulatory Contracts, as described above,<sup>249</sup> that will specify the Exchange and Commission rules for which FINRA and ISE will provide certain regulatory functions, or each Exchange must demonstrate that it independently has the ability to fulfill all of its regulatory obligations.

F. *Examination by the Commission.* Each Exchange must have, and represent in a letter to the staff in the Commission's Office of Compliance Inspections and Examinations that it has, adequate procedures and programs in place to effectively regulate the Exchange.

G. *Trade Processing and Exchange Systems.* Each Exchange must have, and represent in letters to the staff in the Commission's Division of Trading and Markets that it has, adequate procedures and programs in place, as noted in Commission Automation Policy Review guidelines,<sup>250</sup> to effectively process trades and maintain the confidentiality, integrity, and availability of the Exchange's systems.

*It is further ordered*, pursuant to section 36 of the Act,<sup>251</sup> that each Exchange shall be exempt from the rule filing requirements of section 19(b) of

<sup>246</sup> 17 CFR 240.19d–1(c)(2).

<sup>247</sup> 17 CFR 240.17d–2.

<sup>248</sup> See Sections III.E.4 and III.H.2, *supra*.

<sup>249</sup> See Sections III.E.3 and III.H.2, *supra*.

<sup>250</sup> On November 16, 1989, the Commission published its first Automation Review Policy ("ARP I"), in which it created a voluntary framework for self-regulatory organizations to establish comprehensive planning and assessment programs to determine systems capacity and vulnerability. On May 9, 1991, the Commission published its second Automation Review Policy ("ARP II") to clarify the types of review and reports that were expected from SROs. See Securities Exchange Act Release Nos. 27445 (November 16, 1989), 54 FR 48703 (November 24, 1989); and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991).

<sup>251</sup> 15 U.S.C 78mm.

the Act<sup>252</sup> with respect to the FINRA rules the Exchange proposes to incorporate by reference into the Exchange's rules, subject to the conditions specified in this Order.

By the Commission.

**Florence E. Harmon,**  
*Deputy Secretary.*

[FR Doc. 2010-5868 Filed 3-17-10; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 29174; File No. 811-21873]

### American Vantage Companies; Notice of Application

March 11, 2010.

**AGENCY:** Securities and Exchange Commission ("Commission").

**ACTION:** Notice of application for deregistration under section 8(f) of the Investment Company Act of 1940 (the "Act").

**SUMMARY OF APPLICATION:** American Vantage Companies requests an order declaring that it has ceased to be an investment company.

**APPLICANT:** American Vantage Companies (the "Company").

**FILING DATES:** The application was filed on November 25, 2008 and amended on April 30, 2009, November 12, 2009, February 4, 2010 and March 10, 2010.

**HEARING OR NOTIFICATION OF HEARING:** An order granting the requested relief will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicant with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on April 5, 2010 and should be accompanied by proof of service on applicant, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

**ADDRESSES:** Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090. Applicant, P.O. Box 81920, Las Vegas, Nevada 89180.

**FOR FURTHER INFORMATION CONTACT:** Jaea F. Hahn, Senior Counsel, at (202) 551-

6870, or Jennifer L. Sawin, Branch Chief, at (202) 551-6821 (Office of Investment Company Regulation, Division of Investment Management).

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application may be obtained via the Commission's Web site by searching for the file number, or an applicant using the Company name box, at <http://www.sec.gov/search/search.htm> or by calling (202) 551-8090.

### Applicant's Representations

1. The Company is a holding company that operates through its subsidiaries primarily in the gaming and hospitality and corporate staffing businesses. Although the Company was not engaged in the business of investing, reinvesting, owning, holding or trading in securities, the Company registered as a closed-end investment company on June 21, 2006 because it held investment securities that had a value exceeding 40% of the Company's total assets on an unconsolidated basis from March 2005 through March 2006.<sup>1</sup> The Company no longer has investment securities having a value near or exceeding 40% of its total assets nor does it hold itself out as being engaged primarily, nor does it propose in the future to engage primarily, in the business of investing, reinvesting or trading in securities. On March 27, 2008, the Company's board of directors resolved that it would be in the best interest of the Company to deregister from the Act. The Company's stockholders approved a proposal to deregister the Company from the Act on November 14, 2008. The Company seeks an order declaring that it has ceased to be an investment company under the Act.

2. The Company was incorporated in Nevada in 1979 and since then has engaged in the business of recreational and leisure time activities, including casino gaming and hospitality. The Company currently maintains ongoing business operations through its subsidiaries, American Vantage

<sup>1</sup> These investment securities principally consisted of 7,000,000 shares of common stock, and warrants to purchase 1,400,000 shares of common stock, of Genius Products, Inc. ("Genius") acquired when the Company sold its subsidiary American Vantage Media Corporation to Genius, together with a 49% interest in the Border Grill Restaurant ("Border Grill"). The Company privately placed most of its shares of Genius stock and used the net proceeds for working capital and to fund its purchase in September 2007 of Candidates on Demand Group, Inc. ("COD"), a temporary placement agency and recruitment firm which operates as a wholly-owned subsidiary of the Company.

Brownstone, LLC, which focuses on Native American tribal gaming and commercial/jurisdictional gaming, and COD. Despite its registration under the Act, the Company has never represented or stated that it is involved in any business other than gaming, media, restaurants and entertainment and has always emphasized its operating results rather than investment income as a material factor in its business. The Company has never employed an investment advisor nor is there an employee who is specifically assigned to manage the Company's investments.

3. As described more fully in the application, the Company's assets primarily consist of interests in its wholly-owned and majority-owned subsidiaries and a 49% interest in the Border Grill and the Company derives substantially all of its revenues from operations. The Company currently has investment securities that equal approximately 16.4% of its total assets on an unconsolidated basis.<sup>2</sup> For the six months ended June 30, 2009, the Company derived 98.8% of its revenues from its operating subsidiaries. The Company derived only 1.2% of its income from investment assets for the six months ended June 30, 2009.

### Applicant's Legal Analysis

1. Section 8(f) of the Act provides that whenever the Commission, upon application or its own motion, finds that a registered investment company has ceased to be an investment company, the Commission shall so declare by order and upon the taking effect of such order, the registration of such company shall cease to be in effect.

2. Section 3(a)(1)(A) of the Act defines an investment company as any issuer which is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities. Section 3(a)(1)(C) of the Act defines an investment company as any issuer which is engaged or proposes to engage in the business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities having a value exceeding 40 per centum of the value of such issuer's total assets (exclusive of Government securities and cash items) on an unconsolidated basis. Section 3(a)(2) of the Act defines investment securities as all securities except (a) Government securities, (B) securities issued by employees'

<sup>2</sup> The Company's investment assets consist of its 49% interest in Border Grill, auction-rate securities, and its remaining Genius common stock and warrants.