



Circular number:	ISE: 2014-007 ISE Gemini: 2014-011	Contact:	Russ Davidson Head of Market Surveillance
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Subject: Priority Customer Orders and Professional Orders (FAQ)

This Regulatory Circular is an update to Regulatory Circular 2011-011, issued in June 2011. Changes have been made to FAQs three and five to provide clarification regarding how to count complex orders and for “parent” and “child” orders. All other FAQs are unchanged. Members should also review Regulatory Circular 2009-06 for an overview of an Electronic Access Member’s compliance obligations concerning the “Priority Customer Order” and “Professional Order” account categories.

➤ **Counting Specific Order Types**

Members that receive orders directly from beneficial account owners must review their customers’ activity on a least a quarterly basis to determine whether orders that are not for the account of a broker or dealer should be represented as Priority Customer Orders or Professional Orders. Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional Orders for the next calendar quarter.

Question 1: Does the average of 390 orders per day during a calendar month apply only to orders entered on the ISE or to all orders entered by a customer regardless of the options exchanges on which it was entered?

Answer: All orders entered by a customer must be counted when determining the daily average number of orders entered by a beneficial account, regardless of the options exchange to which the orders are routed.

Question 2: Do I need to count each cancel/replace as a new order?

Answer: Yes, if a customer places an order and then submits a cancel/replace, the cancel/replace counts as a second order.

Question 3: Do Immediate or Cancel (IOC) orders, Crossing Orders and Complex Orders count toward the 390 orders on average per day?

Answer: Yes, unless an order type is specifically excluded as noted below, all orders count toward the 390 orders on average per day. A Complex Order, regardless of the number of legs, counts as a single order.

Question 4: If a customer places an order that is “refreshed” (e.g. a reserve or iceberg order) does this count as a single order or multiple orders?

Answer: This would count as a single order.

Question 5: If a customer places a “parent” order that is broken up by either an individual at a broker or dealer into multiple “child” orders or by an algorithm housed at the broker or dealer, do I count the “parent” order or each individual “child” order?

Answer: If a customer places a single order that the broker or dealer then breaks up into multiple parts in order to achieve a specific execution strategy, it is only necessary to count the single “parent” order.

Question 5a: If a customer places a “parent” order that is broken up by either an individual at a non-broker or dealer into multiple “child” orders or by an algorithm housed at a non-broker or dealer, do I count the “parent” order or each individual “child” order?

Answer: If a customer places a single order that the non-broker or dealer breaks up into multiple parts in order to achieve a specific execution strategy, each “child” order must be counted.

Question 5b: If a customer places a “parent” order that is broken up by an algorithm into multiple “child” orders that is licensed from a broker or dealer but is housed with the customer, do I count the “parent” or “child” order?

Answer: If the algorithm identifies and documents the “parent” order and its “child” orders, which can be tracked by the broker or dealer, and is used to achieve a specific execution strategy, it is only necessary to count the single “parent” order.

Question 6: If the volatility used to price the option is changed by a customer or an algorithm, does that need to be counted as a new order?

Answer: Yes. Every time the customer changes the volatility, it is considered a new order.

Question 7: If a “parent” order generates “child” orders that are pegged to the NBBO, is that a single order or do I have to count each cancel/replace?

Answer: A pegged order would count as a new order each time a cancel/replace is used to follow the BBO regardless of whether or not the order was entered by a broker or dealer. In this situation, the customer is specifically instructing the executing broker to cancel/replace orders.

Question 8: Should orders in FLEX options be counted?

Answer: No.

Question 9: Do trades that I receive via CMTA into a beneficial account need to be counted?

Answer: No, trades received via CMTA do not need to be counted. The orders associated with these trades should have already been counted by the firm that received the order from the customer.

Question 10: Do we need to identify the beneficial accounts behind orders that are routed by exchanges?

Answer: No, orders placed by exchanges or market makers that are fulfilling their linkage obligations do not need to be counted.

Question 11: What if I know for certain that none of my customers ever enter anywhere close to 390 order per day? Am I required to build a system to count orders anyway?

Answer: No. The Exchange does not require members that “obviously” do not have accounts that would require orders to be marked Professional to build systems to count orders. A member should document its reasons for believing that it will be in compliance with the rules without actually counting customer orders, and should have reasonable procedures to assure its continuing compliance, such as the existence of risk management systems that would identify any accounts that reached such a high level of activity or other triggers that would cause the firm to re-evaluate its need to implement order-counting systems.

➤ **Non-Member Customers with Multiple Beneficial Accounts**

When evaluating situations where members receive orders from non-member customers with multiple beneficial accounts, the Exchange will apply a “reasonable” standard when looking at whether a member has taken appropriate measures to comply with the requirement to identify and properly mark orders Professional Orders.

Question 12: I have many clients that are each entering orders on behalf of multiple beneficial accounts. Do I need to track each of my customer's orders back to the original beneficial account?

Answer: No, it is not necessary for a member to track every order to the originating beneficial account. An ISE member's obligation in this circumstance will be satisfied if your customer has appropriate policies and procedures in place to properly identify Professional Orders. It is your responsibility to make sure your customers understand the requirements and to have a reasonable basis for believing that they have appropriate procedures in place to properly track their customer's activity and appropriately mark each Professional Orders, if necessary.

Question 13: How do I know if it is "necessary" for my customers to track their customer's activity?

Answer: The Exchange does not intend for firms or customers that "obviously" do not have accounts that would require orders to be marked Professional to build systems to count orders simply to assure compliance with the Professional Order marking requirement. Thus, it may be reasonable for a member to rely on an attestation from a customer that it has no customers that would potentially reach 390 orders per day on average during a month. While the facts will vary, members should adopt an approach that will reasonably assure itself a customer does not have any such accounts. For example, if the nature of the customer's business would not allow for Professional Order activity or if a customer represents that it has certain risk management systems that would identify any accounts that reached such a high level of activity, even if such systems do not actually count orders as specified above, it may be reasonable to rely on the attestation. However, the facts must reasonably support the attestation. For example, if you have a customer that places 500 orders per day but routes orders for 1000 different beneficial accounts all representing individual investors, then it would be reasonable to accept an attestation stating that the customer does not believe it has any accounts for which orders would be required to be marked Professional. On the other hand, if a customer represents very few beneficial accounts and is canceling and replacing several hundred orders per day in the same security across multiple market centers, the ISE would expect an EAM to take a close look at this customer's activity before accepting a representation from the customer that it does not handle any Professional Orders.

Question 14: How do I know if my customer's policies and procedures are "appropriate"? Do I need to conduct surveillance of my customer's order flow?

Answer: If your customer has or potentially has accounts for which orders need to be marked Professional, then you need to need to take reasonable

steps to assure yourself that the customer's policies and procedures are reasonably designed to properly identify Professional Orders. For example, a customer may represent that it has implemented a system to count the orders as specified above, or that it otherwise employs risk-management systems that would identify any account that might need to be analyzed manually. Members are not expected to conduct surveillance of their member customers that represent multiple beneficial accounts, and in most circumstance it will be reasonable for a member to rely on the customer's representation that it has implemented specific policies or procedures. However, if a member has actual knowledge that a customer is not following appropriate procedures or actual knowledge that a customer is not properly identifying Professional Orders, it would not be reasonable to rely on a representation to the contrary from the customer.

Question 15: I still do not know if the policies and procedures in place for a particular customer are necessary or appropriate.

Answer: ISE's Legal and Market Surveillance Departments will work with you to determine whether a particular set of policies and procedures are necessary or appropriate.

➤ **Aggregation of Accounts**

Question 16: If a single person or entity enters orders through multiple accounts, do these orders need to be aggregated?

Answer: Yes, all orders for all beneficial accounts controlled by the same person or entity must be aggregated when determining whether or not they exceed the 390 order limit.

Question 17: *Can I aggregate accounts by Taxpayer Identification Number ("TIN") or by In-Concert Number?*

Answer: Either of these would be acceptable identifiers to use when automatically aggregating orders from related accounts.

Question 18: *Does this mean that orders placed by accounts with different TINs should not be aggregated?*

Answer: No. While the ISE believes it is reasonable to rely on a machine readable identifier for automated surveillance, firms must recognize and aggregate orders from accounts that are obviously connected. If there are three accounts named, "ABC Capital I", "ABC Capital II" and "ABC Capital III" and executions are regularly allocated between these three accounts, ISE would expect a firm to aggregate orders placed by these accounts even if they had different TINs.

➤ **Handling Professional Customers**

Question 19: How do I mark an order “Professional”?

Answer: FIX TAG 204 should be populated with an “8” to denote Professional Orders.

The DTI account type for Professional Orders is value “D”. Professional Orders may also be marked in PreclSE using the ‘Client Category’ drop down menu.

Question 20: How can a Professional account revert to a Priority Customer account?

Answer: Once an account crosses the 390 orders per day on average during any month in a given quarter, its orders must be marked Professional for the entire next quarter. For example, if an account places 500 orders per day on average during April, 200 orders per day on average during May, and 300 orders per day on average during June, all of the orders for that account would have to be marked Professional for the entire third quarter. If this account averages less than 390 orders per day during each month of the third quarter, orders for the account can be marked Priority during the fourth quarter.