

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-64760; File No. SR-ISE-2011-34)

June 28, 2011

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Increase the Position and Exercise Limit for Options on the Standard & Poor's® Depository Receipts (SPDRs®)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 17, 2011, the International Securities Exchange, LLC (the "Exchange" or the "ISE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which items have been prepared by the Exchange. The Exchange filed the proposal as a "non-controversial" proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend the rules of the Exchange to increase the position and exercise limit applicable to options on the Standard and Poor's® Depository Receipts ("SPDRs®").<sup>5</sup> The text of the proposed rule change is available on the Exchange's website

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

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

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

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

<sup>5</sup> "SPDRs®", "Standard & Poor's®", "S&P®", "S&P 500®", "Standard & Poor's 500", and "500" are trademarks of The McGraw-Hill Companies, Inc. SPDRs®, also sometimes referred to colloquially as "spiders", are exchange traded funds ("ETFs") based on the S&P 500® Index. Each share of the traditional SPDRs® ETF (SPDRs® Trust Series 1) holds a stake in the 500 stocks represented by the S&P 500®. SPDRs®, and options thereon, are generally used by large institutions and traders as bets on the

[www.ise.com](http://www.ise.com), at the principal office of the Exchange, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposal is to amend ISE Rules 412 and 414 to increase the position and exercise limit applicable to options on SPDRs®, which are trading under the symbol SPY, from 300,000 to 900,000 contracts on the same side of the market. The Exchange began trading options on SPDRs® on January 10, 2005. That year, the position limit for these options was increased to the current limit of 300,000 contracts on the same side of the market, and has remained unchanged.<sup>6</sup> However, institutional and retail traders have greatly increased their demand for options on SPDRs® for hedging and trading purposes, such that these options have experienced an explosive gain in popularity and have been the most actively traded options for

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overall direction of the market. They are also used by individual retail investors who believe in passive management (index investing).

<sup>6</sup> See Securities Exchange Act Release No. 51042 (January 14, 2005), 70 FR 3412 (January 24, 2005) (SR-ISE-2005-05) (Approval order increasing position and exercise limits for options on SPDRs® from 75,000 contracts to 300,000 contracts on the same side of the market).

the last two years. For example, options on SPDRs® (SPY), the most actively traded options in the U.S. in terms of volume, traded a total of 33,341,698 contracts across all exchanges from March 1, 2011 through March 16, 2011. In contrast, over the same time period, options on the Nasdaq-100 Index® Tracking Stock ("QQQ<sup>SM</sup>"),<sup>7</sup> the third most actively traded options, traded a total of 8,730,718 contracts (less than 26.2% of the volume of options on SPDRs®).

Currently, SPY options have a position limit of only 300,000 contracts on the same side on the market while the significantly lesser-volume QQQ<sup>SM</sup> options, which are comparable to SPY options, have a position limit of 900,000 contracts on the same side of the market. The Exchange believes that SPY options should, like options on QQQ<sup>SM</sup>, have a position limit of 900,000 contracts. Given the increase in volume and continuous unprecedented demand for trading options on SPDRs®, the Exchange believes that the current position limit of 300,000 contracts is too low and inadequate and is a deterrent to the optimal use of the product for hedging and trading purposes. There are multiple reasons to increase the position and exercise limit for SPY options.

First, traders have informed the Exchange that the current SPY option position limit of 300,000 contracts, which has remained flat for more than five years despite the tremendous trading volume increase, is no longer sufficient for optimal trading and hedging purposes. SPY options are, as noted, used by large institutions and traders as a means to invest in or hedge the overall direction of the market. Second, options on

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<sup>7</sup> QQQ<sup>SM</sup> options were formerly traded under the ticker symbol QQQQ<sup>SM</sup>. QQQ<sup>SM</sup>, Nasdaq-100®, Nasdaq-100 Index®, Nasdaq®, and Nasdaq-100 Index Tracking Stock<sup>SM</sup> are trademarks or service marks of The Nasdaq Stock Market, Inc. ("Nasdaq").

SPDRs® are 1/10th the size of options on the S&P 500® Index, traded under the symbol SPX. Thus, a position limit of 300,000 contracts in options on SPDRs® is equivalent to a 30,000 contract position limit in options on SPX.<sup>8</sup> Traders who trade options on SPDRs® to hedge positions in SPX options (and the SPDRs® ETF based on SPX, SPDRs® Trust Series 1) have indicated on several occasions that the current position limit for options on SPDRs® is simply too restrictive,<sup>9</sup> which may adversely affect their (and the Exchange's) ability to provide liquidity in this product. And third, the products that are perhaps most comparable to options on SPDRs®, namely options on QQQ<sup>SM</sup>, are subject to a 900,000 contract position limit on the same side of the market.<sup>10</sup> This has, in light of the huge run-up in SPY option trading making them the number one nationally-ranked option in terms of volume, resulted in a skewed and unacceptable SPY option position limit. Specifically, the position limit for options on SPDRs® at 300,000 contracts is but 33% of the position limit for the less active options on QQQ<sup>SM</sup> at 900,000 contracts.<sup>11</sup> The Exchange proposes that options on SPDRs® similarly be subject to a position and exercise limit of 900,000 contracts.

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<sup>8</sup> Chicago Board Options Exchange, which lists and trades SPX options, has established that there is no position limit on SPX options. See CBOE Rule 24.4 and Securities Exchange Act Release No. 44994 (October 26, 2001), 66 FR 55722 (November 2, 2001) (SR-CBOE-2001-22) (order approving permanent elimination of SPX options position limit).

<sup>9</sup> See supra note 3.

<sup>10</sup> See Securities Exchange Act Release No. 51295 (March 2, 2005), 70 FR 11292 (March 8, 2005) (SR-ISE-2005-14).

<sup>11</sup> Similarly to options on SPDRs® (SPY) being 1/10th the size of options on the related index S&P 500® Index (SPX), so options on the Nasdaq-100 Index® Tracking Stock (QQQ<sup>SM</sup>) are 1/10th the size of options on the related index NASDAQ-100 Index (NDX). The position limit for QQQ<sup>SM</sup> options and its related index NDX have a comparable relationship to that of SPY options and SPX. That is, the position limit for options on QQQ<sup>SM</sup> is 900,000 contracts and there is no positions limit for NDX options. See supra note 7 and Securities Exchange Act Release No. 52650 (October 21, 2005), 70 FR 62147

Under this proposal, the Exchange's options reporting requirement would continue abated. Thus, the Exchange would require that, just like for options on QQQ<sup>SM</sup>, each member or member organization that maintains a position in SPDRs<sup>®</sup> options on the same side of the market, for its own account or for the account of a customer, must report certain information. This information would include, but would not be limited to, the option position, whether such position is hedged and if so, a description of the hedge and if applicable, the collateral used to carry the position. Exchange market makers would continue to be exempt from this reporting requirement as information regarding positions held by market makers can be accessed through the Exchange's market surveillance systems. In addition, the general reporting requirement for customer accounts that maintain an aggregate position of 200 or more option contracts ("large positions") would remain at this level for options on SPDRs<sup>®</sup>.

The Exchange believes that position and exercise limits, at their current levels, no longer serve their stated purpose. There has been a steadfast and significant increase over the last decade in the overall volume of exchange-traded options; position limits, however, have not kept up with the volume. Part of this volume is attributable to a corresponding increase in the number of overall market participants, which has, in turn, brought about additional depth and increased liquidity in exchange-traded options.<sup>12</sup>

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(October 28, 2005) (SR-CBOE-2001-41) (order approving elimination of NDX options position limit).

<sup>12</sup> The Commission has previously observed that: Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations and for corners or squeezes of the underlying market. In addition such limits serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes. See Securities Exchange Act Release No.

As the anniversary of listed options trading approaches its fortieth year, the Exchange believes that the existing surveillance procedures and reporting requirements at ISE, other options exchanges, and at the several clearing firms are capable of properly identifying unusual and/or illegal trading activity. In addition, routine oversight inspections of the Exchange's regulatory programs by the Commission have not uncovered any material inconsistencies or shortcomings in the manner in which the Exchange's market surveillance is conducted. These procedures utilize daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both options and underlying stocks.<sup>13</sup>

Furthermore, large stock holdings must be disclosed to the Commission by way of Schedules 13D or 13G.<sup>14</sup> Options positions are part of any reportable positions and, thus, cannot be legally hidden. Moreover, the Exchange's requirement that members file reports with the Exchange for any customer who held aggregate large long or short positions of any single class for the previous day will continue to serve as an important part of the Exchange's surveillance efforts.

The Exchange believes that the current financial requirements imposed by the Exchange and by the Commission adequately address concerns that a member or its customer may try to maintain an inordinately large un-hedged position in an option, particularly on SPDRs®. Current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must

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39489 (December 24, 1997), 63 FR 276 (January 5, 1998) (SR-CBOE-97-11) (order approving).

<sup>13</sup> These procedures have been effective for the surveillance of SPY options trading and will continue to be employed.

<sup>14</sup> 17 CFR 240.13d-1.

maintain for a large position held by it or by its customer. In addition, the Commission's net capital rule, Rule 15c3-1 under the Act,<sup>15</sup> imposes a capital charge on members to the extent of any margin deficiency resulting from a higher margin requirement.

The Exchange believes that while position limit on options on QQQs<sup>SM</sup>, which as noted are similar to options on SPDRs®, has been gradually expanded from 75,000 contracts to the current level of 900,000 contracts in 2005, there have been no adverse affects on the market as a result of this position limit increase. Likewise, there have been no adverse affects on the market from expanding the position limit for options on SPDRs® from 75,000 contracts to the current level of 300,000 contracts in 2005.

The Exchange also believes that restrictive option position limits prevent large customers, such as mutual funds and pension funds, from using options to gain meaningful exposure to and hedging protection through the use of options on SPDRs®. This can result in lost liquidity in both the options market and the equity market. The proposed position limit increase will remedy this situation to the benefit of large as well as retail traders, investors, and public customers. The Exchange believes that increasing position and exercise limits for options on would lead to a more liquid and competitive market environment for options on SPDRs® that would benefit customers interested in this product.

Finally, the Exchange believes that the proposed increase in position and exercise limits on options on SPDRs® is required for competitive purposes as well as for purposes of consistency and uniformity among the competing options exchanges. This, taken in conjunction with the permanent establishment of other separate increased position and exercise limits, all as

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<sup>15</sup> 17 CFR 240.15c3-1.

noted above, supports the Exchange's current proposal to increase the position and exercise limits applicable to options on SPDRs®.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the requirements of Section 6(b) of the Securities Exchange Act of 1934,<sup>16</sup> in general, and Section 6(b)(5) of the Act of 1934,<sup>17</sup> in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. Specifically, the Exchange believes that the structure of the SPDRs® options and the considerable liquidity of the market for SPDRs® options diminish the opportunity to manipulate this product and disrupt the underlying market that a lower position limit may protect against. Further, the Exchange believes that this proposal will be beneficial to large market makers (which generally have the greatest potential and actual ability to provide liquidity and depth in this product), as well as retail traders, investors, and public customers.

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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<sup>16</sup> 15 U.S.C. 78(f)(b).

<sup>17</sup> 15 U.S.C. 78(f)(b)(5).



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

Because the foregoing proposed rule change does not (i) significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission,<sup>18</sup> the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>19</sup> and Rule 19b-4(f)(6)<sup>20</sup> thereunder.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative prior to 30 days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, because it will enable the Exchange immediately to compete

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<sup>18</sup> The Exchange has satisfied this requirement.

<sup>19</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>20</sup> 17 C.F.R. 240.19b-4(f)(6).

with another exchange that already has adopted the higher position and exercise limit for options on SPDRs®. Therefore, the Commission designates the proposal operative upon filing.<sup>21</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

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

##### Electronic comments:

- Use the Commission's Internet comment form <http://www.sec.gov/rules/sro.shtml>; or
- Send an E-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-ISE-2011-34 on the subject line.

##### Paper comments:

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

All submissions should refer to File Number SR-ISE-2011-34. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of

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<sup>21</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the ISE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2011-34 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>22</sup>

Cathy H. Ahn  
Deputy Secretary

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<sup>22</sup> 17 CFR 200.30-3(a)(12).