SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66614; File No. SR-ISE-2012-22)

March 16, 2012

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change to Add an Index Option Product for Trading on the Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on March 9, 2012, 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 self-regulatory organization. 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 is proposing to amend its rules to trade options on the ISE Max SPY™ Index ("ISE Max SPY"), a newly-developed, ISE proprietary index (patent pending). The ISE Max SPY is designed to represent 10 times the value of the published prices in the SPDR® S&P 500® ETF Trust. The Exchange also proposes to list and trade long-term options on the ISE Max SPY. Options on the Max SPY will be p.m. cash-settled and will have European-style exercise provisions.

The text of the proposed rule change is available on the Exchange's Internet website at http://www.ise.com, at the principal office of the Exchange, and at the Commission's Public Reference Room.

---

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b-4.

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 self-regulatory organization 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 Exchange proposes to amend its Rules 2001, 2004 and 2009 to provide for the listing and trading of options on the ISE Max SPY™ index, a newly-developed, ISE proprietary index (patent pending). The ISE Max SPY is designed to represent 10 times the value of the published share prices in the SPDR® S&P 500® ETF Trust. In addition to options on the ISE Max SPY, the Exchange may list long-term options on ISE Max SPY.[3] Options on the ISE Max SPY will be P.M. cash-settled and will have European-style exercise provisions.

The ISE Max SPY Index is constructed using the share prices of the SPDR® S&P 500® ETF Trust (the "Trust", which is commonly known by its exchange symbol "SPY"). According to the Trust's prospectus, SPY is based on the S&P 500®, which is a capitalization-weighted index of 500 stocks from a broad range of industries. The component stocks are weighted according to the total market value of their outstanding shares. The impact of a component's price change is proportional to the issue's total market share value, which is the share price times

[3] Under ISE Rule 2009(b), "Long-Term Index Options Series," the Exchange may list long-term options that expire from 12 to 60 months from the date of issuance.

the number of shares outstanding. These are all summed for all 500 stocks and divided by a predetermined base value. The base value for the S&P 500® is adjusted to reflect changes in capitalization resulting from, among other things, mergers, acquisitions, stock rights and substitutions. The ISE Max SPY is calculated by multiplying the share prices of SPY by a factor of 10 and rounding to the tenths place. For example, if the share price for SPY is 112.35 then the ISE Max SPY value would yield a value of 1123.50 for the ISE Max SPY.

The Exchange believes that the proposed product would benefit investors in several ways. First, the European exercise style will allow investors to engage in certain trading strategies involving in-the-money options without the risk of being assigned prior to expiration. The Exchange also notes that options with a European exercise style may exhibit lower premiums than those with an American exercise style, all other terms being equal, because the risks of early assignment may contribute to higher prices for options with an American style exercise. Further, the cash-settlement feature would allow investors to retain their existing underlying equity or exchange-traded fund ("ETF") positions if they engage in short options strategies, as opposed to physically-settled options that also have American style exercise where an assignment could require an investor to adjust its portfolio in the underlying shares.

The Exchange also believes that a large underlying index would appeal to market participants that have different investment goals. For example, a smaller index size would appeal to investors seeking lower-priced options, while a larger index size would appeal to investors seeking to reduce their transaction costs by having to purchase fewer contracts.

As proposed, the proposal would become effective on a pilot program basis for a period of fourteen months. If the Exchange were to propose an extension of the program or should the Exchange propose to make the program permanent, then the Exchange would submit a filing

proposing such amendments to the program. The Exchange notes that any positions established under the pilot would not be impacted by the expiration of the pilot. For example, a position in a p.m.-settled series that expires beyond the conclusion of the pilot period could be established during the 14-month pilot. If the pilot program were not extended, then the position could continue to exist. However, the Exchange notes that any further trading in the series would be restricted to transactions where at least one side of the trade is a closing transaction.

As part of the pilot program, the Exchange would also submit a pilot program report to the Commission at least two months prior to the expiration date of the program (the "annual report"). As described below, the annual report would contain an analysis of volume, open interest and trading patterns. The analysis would examine trading in the proposed option product as well as trading in the securities that comprise the S&P 500® index. In addition, for series that exceed certain minimum open interest parameters, the annual report would provide analysis of index price volatility and share trading activity. The annual report would be provided to the Commission on a confidential basis.

The annual report would contain the following volume and open interest data:

(1) monthly volume aggregated for all trades;

(2) monthly volume aggregated by expiration date;

(3) monthly volume for each individual series;

(4) month-end open interest aggregated for all series;

(5) month-end open interest for all series aggregated by expiration data [sic]; and

(6) month-end open interest for each individual series.

In addition to the annual report, the Exchange would provide the Commission with interim reports of the information listed in Items (1) through (6) above periodically as required by

the Commission while the pilot is in effect. These interim reports would also be provided on a confidential basis. Additionally, the annual report would contain the following analysis of trading patterns in Expiration Friday, p.m.-settled ISE Max SPY options series in the pilot:

(1) a time series analysis of open interest; and

(2) an analysis of the distribution of trade sizes.

Also, for series that exceed certain minimum parameters, the annual report would contain the following analysis related to index price changes and underlying share trading volume at the close on Expiration Fridays:

(1) a comparison of index price changes at the close of trading on a given Expiration Friday with comparable price changes from a control sample. The data would include a calculation of percentage price changes for various time intervals and compare that information to the respective control sample. Raw percentage price change data as well as percentage price change data normalized for prevailing market volatility, as measured by the CBOE Volatility Index (VIX), would be provided; and

(2) a calculation of share volume of a sample set of the component securities representing an upper limit on share trading that could be attributable to expiring in-the-money series. The data would include a comparison of the calculated share volume for securities in the sample set to the average daily trading volumes of those securities over a sample period.

The minimum open interest parameters, control sample, time intervals, method for randomly selecting the component securities, and sample periods would be determined by the Exchange and the Commission.

Index Design and Composition

The ISE Max SPY Index is designed to provide larger scale exposure to, and is calculated using, the share prices of SPY. Each Trust unit, (i.e., each share of SPY) represents an undivided ownership interest in the Trust. Shares of SPY trade like any other equity security, and are listed and traded on NYSE Arca.

As discussed above, the ISE Max SPY is calculated by multiplying the share prices of SPY by a factor of 10 and rounding to the tenths place. For example, if the share price for SPY is 112.35 then the ISE Max SPY value would yield a value of 1123.50 for the ISE Max SPY.

Index Calculation and Index Maintenance

Real-time index levels for the ISE Max SPY shall be calculated by ISE or its agent, and shall be disseminated by ISE every 15 seconds during the Exchange's regular trading hours to market information vendors via the Options Price Reporting Authority ("OPRA").[4] The settlement value for the ISE Max SPY Index is calculated using the Net Asset Value ("NAV") of the fund, as calculated by the Exchange, on a per share basis, times ten.[5] The NAV of an ETF is the per-share dollar amount of the fund which is calculated by dividing the total value of all the securities in its portfolio, less any liabilities, by the number of fund shares outstanding. In

[4] The Exchange will also disseminate these values to its members.

[5] The settlement value that the Exchange calculates may be different from the NAV published by the trustee of the Trust. According to the prospectus of the Trust, the trustee may deem prices of the Trust's portfolio securities to be inappropriate, and may use the prices of another market other than the NYSE, or may appraise the value of the securities itself. Additionally, the Trust uses the NYSE's closing prices of all the portfolio securities even though several of those securities are not listed on the NYSE (as of the close on February 24, 2012, one hundred components of the SPY portfolio, which represented 20% of the total portfolio count and 21.74% of the weighting, were listed on Nasdaq). In calculating ISE Max SPY, the Exchange uses the published closing prices from the primary market of those securities.

general, equity ETFs use the closing prices of each of the fund's holdings to determine the total value of all the securities in its portfolio. In the case of SPY, the closing prices of the portfolio securities are determined by the closing auction processes of the NYSE for each of those securities.

The Exchange will also notify the staff of the Division of Trading and Markets of the Commission immediately in the event values of the ISE Max SPY Index are not disseminated every 15 seconds by a widely available source. In the event the ISE Max SPY Index ceases to be maintained or calculated, or its values are not disseminated every 15 seconds by a widely available source, the Exchange will not list any additional series for trading and will limit all transactions in such options to closing transactions only for the purpose of maintaining a fair and orderly market and protecting investors.

Exercise and Settlement Value

Options on the ISE Max SPY will expire on the Saturday following the third Friday of the expiration month. Trading in options on the ISE Max SPY will normally cease at 4:15 p.m. (EST), except for expiring contracts, which will cease trading at 4:00 p.m. (EST) on the Friday preceding an expiration Saturday. Non-expiring contracts will continue to trade until 4:15 p.m. (EST). The index value for exercise of the ISE Max SPY options will be calculated by ISE based on the NAV of the fund, on a per share basis, times ten.

The Commission recently determined that it was appropriate to reintroduce p.m.-settlement to cash-settled index options when it approved C2 Options Exchange, Incorporated's ("C2") SPXPM.[6] As discussed above, settlement value of the ISE Max SPY utilizes the prices of

---

[6] See Securities Exchange Act Release No. 65256 (September 2, 2011), 76 FR 55969 (September 9, 2011) (SR-C2-2011-008) ("SPXPM Filing").

the stocks held in the SPDR® S&P 500® ETF Trust. These stocks are also used in the calculation of the S&P 500® index underlying C2's SPXPM. Therefore, all the arguments supporting p.m.-settlement in the order approving SPXPM apply here.

Reintroduction of P.M. Settlement

When cash-settled[7] index options were first introduced in the 1980s, they generally utilized closing-price settlement procedures (i.e., p.m.-settlement).[8] The Commission became concerned about the impact of p.m.-settlement on cash-settled index options on the markets for the underlying stocks at the close on expiration Fridays.[9] These concerns were heightened during

---

[7] The seller of a "cash settled" index option pays out the cash value of the applicable index on expiration or exercise. A "physically settled" option, like equity and ETF options, involves the transfer of the underlying asset rather than cash. See Characteristics and Risks of Standardized Options, available at: http://www.theocc.com/components/docs/riskstoc.pdf, for a discussion of settlement.

[8] The exercise settlement value for a p.m.-settled index option is generally determined by reference to the reported level of the index as derived from the closing prices of the component securities (generally based on the closing prices as reported by the primary exchange on which the stock is listed) on the last business day before expiration (e.g., the Friday before Saturday expiration). See Characteristics and Risks of Standardized Options, available at: http://www.theocc.com/components/ docs/riskstoc.pdf, for a discussion of settlement value.

[9] See, e.g., Securities Exchange Act Release Nos. 45956 (May 17, 2002), 67 FR 36740 (May 24, 2002) (adopting release concerning cash settlement and regulatory halt requirements for security futures products) ("Regulators and self-regulators were concerned that the liquidity constraints faced by the securities markets to accommodate expiration related buy or sell programs at the market close on expiration Fridays could exacerbate ongoing market swings during an expiration and could provide opportunities for entities to anticipate these pressures and enter orders as part of manipulative or abusive trading practices designed to artificially drive up or down share prices."); 24367 (April 17, 1987), 52 FR 13890 (April 27, 1987) (SR–CBOE–87–11) (order approving a proposal for S&P 500 index options with an exercise settlement value based on an index value derived from opening, rather than closing, prices); and 32868 (September 10, 1993), 58 FR 48687 (September 10, 1993) (notice of filing and order granting accelerated approval of proposed rule change by the New York Stock Exchange, Inc. ("NYSE") relating to changes in auxiliary closing procedures for expiration days) (stating, "[a]s long as some index derivative products continue to expire based on closing stock prices on

the quarterly expirations of the third Friday of March, June, September and December when options, index futures, and options on index futures all expire simultaneously. P.m.-settlement was believed to have contributed to above average volume and added market volatility on those days, which sometimes led to sharp price movements during the last hour of trading.[10] As a consequence, the close of trading on the quarterly expiration Friday became known as the "triple witching hour." Besides contributing to investor anxiety, heightened volatility during the expiration periods created the opportunity for manipulation and other abusive trading practices in

---

expiration Fridays, the Commission agrees with the NYSE that such procedures are necessary to provide a mechanism to handle the potential large imbalances that can be engendered by firms unwinding index derivative related positions"). The cash settlement provisions of stock index futures and options contracts facilitated the growth of sizeable index arbitrage activities by firms and professional traders and made it relatively easy for arbitrageurs to buy or sell the underlying stocks at or near the market close on expiration Fridays (i.e., the third Friday of the expiration month) in order to "unwind" arbitrage-related positions. These types of unwinding programs at the close on expiration Fridays often severely strained the liquidity of the securities markets as the markets, and in particular the specialists on the NYSE, faced pressure to attract contra-side interest in the limited time that was permitted to establish closing prices. See Securities Exchange Act Release No. 44743 (August 24, 2001), 66 FR 45904 (August 30, 2001) (File No. S7–15–01) (proposing release concerning cash settlement and regulatory halt requirements for security futures products).

[10] See, e.g., Securities Exchange Act Release Nos. 24276 (March 27, 1987); 52 FR 10836 (April 3, 1987) (notice of filing and order granting accelerated approval to a proposed rule change by the NYSE relating to opening price settlement of expiring NYSE Composite and Beta Index options); 37894 (October 30, 1996), 61 FR 6987 [sic] (November 5, 1996) (notice of filing and order granting accelerated approval of proposed rule change by the NYSE permanently approving the expiration day auxiliary closing procedures pilot program); and 45956 (May 17, 2002), 67 FR 36740 (May 24, 2002) (adopting release concerning cash settlement and regulatory halt requirements for security futures products) (reaffirming the Commission's view of the advantages of a.m. settlement). See also Hans Stoll and Robert Whaley, Expiration Day Effects of Index Options & Futures (March 15, 1986) (noting that share volume on the NYSE was much higher in the last hour of a quarterly expiration Friday when both options and futures expire than on non-expiration Fridays).

anticipation of the liquidity constraints.[11]

In light of the concerns with p.m.-settlement and to help ameliorate the price effects associated with expirations of p.m.-settled, cash-settled index products, in 1987, the Commodity Futures Trading Commission ("CFTC") approved a rule change by the Chicago Mercantile Exchange to provide for a.m.-settlement for index futures, including futures on the S&P 500® index.[12] The Commission subsequently approved a rule change by the Chicago Board Options Exchange ("CBOE") to list and trade a.m.-settled S&P 500® index options.[13] In 1992, the

---

11 See, e.g., Securities Exchange Act Release No. 45956 (May 17, 2002), 67 FR 36740 (May 24, 2002) (adopting release concerning cash settlement and regulatory halt requirements for security futures products) (explaining that entities could take advantage of illiquidity resulting from the unwinding of arbitrage-related positions on expiration Fridays to manipulate share prices).

12 See Proposed Amendments Relating to the Standard and Poor's 500, the Standard and Poor's 100 and the Standard Poor's OTC Stock Price Index Futures Contract, 51 FR 47053 (December 30, 1986) (notice of proposed rule change from the Chicago Mercantile Exchange). See also Securities Exchange Act Release No. 24367 (April 17, 1987), 52 FR 13890 (April 27, 1987) (SR–CBOE–87–11) (noting that the Chicago Mercantile Exchange moved the S&P 500® futures contract's settlement value to opening prices on the delivery date). The exercise settlement value for an a.m.-settled index option is determined by reference to the reported level of the index as derived from the opening prices of the component securities on the business day before expiration.

13 See Securities Exchange Act Release No. 24367 (April 17, 1987), 52 FR 13890 (April 27, 1987) (SR–CBOE–87–11) (order approving a proposal for S&P 500 index options with an exercise settlement value based on an index value derived from opening, rather than closing, prices). At the time it approved CBOE's introduction of a.m. settlement for cash settled index options, the Commission identified two benefits to a.m. settlement for cash-settled index options. See Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (SR–CBOE–92–09). First, it provides additional time to test price discovery, as market participants have the remainder of the regular trading day to adjust to opening session price movements and determine whether those movements reflect changes in fundamental values or short-term supply and demand conditions. Second, it provides more opportunity to trade out of positions acquired during the opening auction. In this respect, attracting contra-side interest to a single-priced auction to offset an order imbalance (such as those attributable to index arbitrage) may more readily be achieved in an opening auction on Friday morning than a closing auction on Friday afternoon because the morning session allows market participants that have

Commission approved CBOE's proposal to transition all of its European-style cash-settled options on the S&P 500® index to a.m.-settlement.[14] Thereafter, the Commission approved proposals by the options markets to transfer most of their cash-settled index products to a.m.-settlement.[15]

The Commission and the CFTC noted the benefits of a.m.-settlement in a 2001 joint release concerning securities futures, where they observed that "the widespread adoption of opening-price settlement procedures in index futures and options has served to mitigate the liquidity strains that had previously been experienced in the securities markets on expirations."[16]

---

provided that liquidity to have the remainder of the regular trading day to liquidate their positions. In contrast, positions acquired in a Friday afternoon closing auction generally cannot be liquidated as readily and efficiently until the following Monday. Holding positions overnight, or over a weekend, may entail greater risk than holding intraday positions. To accept such risk (real or perceived), market participants generally will require a greater premium, which may translate into greater price concessions, and thus lead to greater volatility in the closing auction. In other words, a consequence of p.m. settlement may be enhanced volatility at the close. See, e.g., Securities Exchange Act Release No. 44743 (August 24, 2001), 66 FR 45904 at 45908 (August 30, 2001) ("Steep discounts (premiums) were necessary in part because traders who bought (sold) stocks to offset unwinding programs had to maintain their newly acquired long (short) positions over the weekend—during which time they were subject to considerable market risk.").

[14] See Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (SR–CBOE–92–09) (order approving CBOE's proposal relating to position limits for SPX index options based on the opening price of component securities).

[15] CBOE's index options on the S&P 100® (OEX), however, kept their p.m. settlement. See Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (SR–CBOE–92–09). No futures or options on futures trade on the S&P 100 index. Other types of options utilize p.m. settlement, including physically-settled single-stock options and options on ETFs.

[16] See Securities Exchange Act Release No. 44743 (August 24, 2001), 66 FR 45904 at 45908 (August 30, 2001) (proposing release for a joint rule between the Commission and the CFTC generally stipulating, among other provisions, that the final settlement price for each cash-settled security futures product fairly reflect the opening price of the underlying security or securities). See also Securities Exchange Act Release No. 45956 (May 17, 2002), 67 FR 36740 at 36741–42 (May 24, 2002) (adopting release concerning cash settlement and regulatory halt requirements for security futures products in which the

Since 1992, the Commission has approved proposals that provide for cash-settled index options with p.m.-settlement on a limited basis for options products that generally are characterized by lower relative volume and that generally do not involve settlement on the third Friday of a month.[17] At the time of each approval, the Commission stated that limited approvals on a pilot basis would allow the exchange and the Commission to monitor the potential for adverse market effects and modify or terminate the pilots, if necessary. Notably, with the exception of FLEX Index options, these recently-approved p.m.-settled contracts do not involve

---

Commission reaffirmed the advantages of a.m. settlement) ("[O]pening price settlement procedures offered several features that enabled the securities markets to better handle expiration-related unwinding programs.").

[17] In particular, in 1993, the Commission approved CBOE's proposal to list and trade p.m.-settled, cash-settled options on certain broad-based indexes expiring on the first business day of the month following the end of each calendar quarter ("Quarterly Index Expirations"). See Securities Exchange Act Release No. 31800 (February 1, 1993), 58 FR 7274 (February 5, 1993) (SR–CBOE–92–13). In 2006, the Commission approved, on a pilot basis, CBOE's listing of p.m.-settled index options expiring on the last business day of a calendar quarter ("Quarterly Options Series"). See Securities Exchange Act Release No. 54123 (July 11, 2006), 71 FR 40558 (July 17, 2006) (SR–CBOE–2006–65). In January 2010, the Commission approved CBOE's listing of p.m.-settled FLEX options on a pilot basis. See Securities Exchange Act Release No. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010) (SR–CBOE–2009–087) (order approving rule change to establish a pilot program to modify FLEX option exercise settlement values and minimum value sizes). FLEX options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. Prior to 2010, only a.m. settlement based on opening prices of the underlying components of an index could be used to settle a FLEX index option if it expired on, or within two business days of, a third-Friday-of-the month expiration ("Blackout Period"). Last year, the Commission approved a pilot program to permit FLEX index options with p.m. settlement that expire within the Blackout Period. See Securities Exchange Act Release No. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010) (SR–CBOE–2009–087). In September 2010, the Commission approved CBOE's listing of p.m.-settled End of Week expirations (expiring on each Friday, other than the third Friday) and End of Month expirations (expiring on the last trading day of the month) for options on broad-based indexes, also on a pilot basis. See Securities Exchange Act Release No. 62911 (September 14, 2010), 75 FR 57539 (September 21, 2010) (SR–CBOE–2009–075).

expiration on the third Friday of the month. These new contracts, including FLEX, have also been characterized by limited volume, and would not be expected to have a pronounced effect on volatility in the underlying securities at the close as a result.

The concerns from 18 years ago that led to the transition to a.m.-settlement for index derivatives have been largely mitigated. Expiration pressure in the underlying cash markets at the close has been greatly reduced with the advent of multiple primary listing and unlisted trading privilege markets and trading is now widely dispersed among many market centers. Further, opening procedures in the 1990s were deemed acceptable to mitigate one-sided order flow driven by index option expiration and that [sic] today's more sophisticated automated closing procedures should afford a similar, if not greater, level of comfort. Specifically, many markets, notably The NASDAQ Stock Market LLC ("Nasdaq") and the NYSE, now utilize automated closing cross procedures and have closing order types that facilitate orderly closings, and that [sic] these closing procedures are well equipped to mitigate imbalance pressure at the close. In addition, ISE believes that after-hours trading now provides market participants with an alternative to help offset market-on-close imbalances.

Also, as noted in the SPXPM Filing, for roughly five years (1987–1992) CBOE listed both a.m.- and p.m.-settled SPX and did not observe any related market disruptions during that period in connection with the dual a.m./p.m.-settlement.[18] Finally, ISE believes that p.m.-settled options predominate in the over-the-counter ("OTC") market, and ISE is not aware of any adverse effects in the underlying cash markets attributable to the considerable volume of OTC trading. ISE is merely trying to offer a p.m.-settled product in an exchange environment which

---

[18] See SPXPM Filing, supra note 6, at 55974.

offers the benefit of added transparency, price discovery and stability. The ISE asserts that given the changes since the 1980s, concerns with p.m.-settlement are not applicable in today's market because closing procedures on the cash equities markets have become more automated with real time data feeds that are distributed to a wider array of market participants.

Finally, in the SPXPM Filing, C2 estimates that 95% of OTC options based on the S&P 500® index are p.m.-settled,[19] therefore ISE Max SPY will attract some of that trading interest. ISE notes that doing so would be consistent with the objectives of the Dodd–Frank Wall Street Reform and Consumer Protection Act and could help mitigate counterparty risks faced by OTC market participants.

Contract Specifications

The contract specifications for options on the ISE Max SPY are set forth in Exhibit 3-2. Options on the ISE Max SPY are European-style and p.m.-settled. The Exchange's standard trading hours for broad-based index options (9:30 a.m. to 4:15 p.m., New York time), as set forth in Rule 2008(a), will apply to the trading of options on the ISE Max SPY. Exchange rules that are applicable to the trading of options on broad-based indexes will also apply to the trading of ISE Max SPY options.[20] Specifically, the trading of ISE Max SPY options will be subject to, among others, Exchange rules governing margin requirements and trading halt procedures for index options. Further, ISE Max SPY options shall be quoted and traded in U.S. dollars.

For options on the ISE Max SPY, the Exchange proposes that there would be no position limits since the index is based on the published prices of the stocks held in the SPDR® S&P

---

19 Id. At 55975.

20 See ISE Rules 2000 through 2013.

500® ETF Trust.[21] As discussed above, C2 received approval to list and trade cash-settled S&P 500® index options with no position limits.[22] The Exchange believes that ISE Max SPY should have no position limits for the same reasons suggested by C2 for SPXPM.[23] The settlement value calculated by ISE would use the portfolio components of the SPY Trust, which are the same as the components of the S&P 500® index. C2 has stated that the settlement value it is using for SPXPM is based on the closing value of the S&P 500® which is calculated using the closing prices of the index components. Similarly, ISE would be calculating the settlement value using the published closing prices of the portfolio securities of the SPDR® S&P 500® ETF Trust, thereby benefitting from the same considerable aggregate capitalization.

To determine appropriate position limits for this product, the Commission requested that the Exchange apply a model, such as the Dutt-Harris model,[24] whereby the authors developed a model to determine appropriate position limits for cash settled index derivatives. The authors concluded that position limits are not as important for broad-based index derivative contracts that are cash settled because they are composed of highly liquid and well-followed securities. As such, the authors note that it would require very high trading volumes to manipulate the underlying securities and, consequently, any attempted manipulation would be more easily detectable and prosecutable. The position limits suggested by the Dutt-Harris model for an S&P 500®-based index option would be so large as to be irrelevant and position limits of such

---

21 There would be reporting requirements pursuant to Rule 415, Reports Related to Position Limits.

22 See note 6.

23 Id.

24 See The Journal of Futures Markets, Vol. 25, no. 10, 945-965 (2005) (Position Limits for Cash-Settled Derivative Contracts by Hans R. Dutt and Lawrence E. Harris) ("Dutt-Harris Paper").

magnitude would attract scrutiny from surveillance systems that would, as a consequence, serve as an effective substitute for position limits. The premise of this conclusion is based upon the broad range and deep liquidity of securities that comprise the S&P 500®, which are the same portfolio securities whose published prices are used to calculate the settlement value of the ISE Max SPY.

The Exchange believes that the existing surveillance procedures and reporting requirements at ISE, other options exchanges, and at the 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.[25] Accordingly, ISE's market surveillance has been and will continue to be rigorous and more than adequate to address any manipulation concerns.

The Exchange proposes to apply broad-based index margin requirements for the purchase and sale of options on the ISE Max SPY. Accordingly, purchases of put or call options with 9 months or less until expiration must be paid for in full. Writers of uncovered put or call options must deposit / maintain 100% of the option proceeds, plus 15% of the aggregate contract value (current index level x $100), less any out-of-the-money amount, subject to a minimum of the option proceeds plus 10% of the aggregate contract value for call options and a minimum of the option proceeds plus 10% of the aggregate exercise price amount for put options.

---

[25] These procedures have been effective for the surveillance of SPY options trading and will continue to be employed.

The Exchange proposes to set minimum strike price intervals for ISE Max SPY options at 1 point intervals. The minimum tick size for series trading below $3 shall be $0.05, and for series trading at or above $3 shall be $0.10.

The Exchange proposes to list options on the ISE Max SPY in the twelve consecutive near-term expiration months.[26] In addition, long-term option series having up to sixty months to expiration may be traded.[27] The trading of long-term ISE Max SPY options shall also be subject to the same rules that govern the trading of all the Exchange's index options, including sales practice rules, margin requirements, and trading rules.

Chapter 6 of the Exchange's rules is designed to protect public customer trading and shall apply to the trading of options on the ISE Max SPY. Specifically, ISE Rules 608(a) and (b) prohibit Members from accepting a customer order to purchase or write an option unless such customer's account has been approved in writing by a designated Options Principal of the Member. Additionally, ISE's Rule 610 regarding suitability is designed to ensure that options are only sold to customers capable of evaluating and bearing the risks associated with trading in this instrument. Further, ISE Rule 611 permits members to exercise discretionary power with respect to trading options in a customer's account only if the Member has received prior written authorization from the customer and the account had been accepted in writing by a designated Options Principal. ISE Rule 611 also requires designated Options Principals or Representatives of a Member to approve and initial each discretionary order on the day the discretionary order is entered. Finally, ISE Rule 609, Supervision of Accounts, Rule 612, Confirmation to Customers,

---

[26] See Rule 2009(a)(3).

[27] See Rule 2009(b)(1).

and Rule 616, Delivery of Current Options Disclosure Documents and Prospectus, will also apply to trading in of [sic] options on the ISE Max SPY.

Surveillance and Capacity

The Exchange represents that it has an adequate surveillance program in place for options traded on the ISE Max SPY. The ISE Market Surveillance Department conducts routine surveillance in approximately 30 discrete areas. Index products and their respective symbols are integrated into the Exchange's existing surveillance system architecture and are thus subject to the relevant surveillance processes. This is true for both surveillance system processing and manual processes that support the ISE's surveillance program.

Finally, the Exchange has the necessary systems capacity to support new options series that will result from the introduction of options on the ISE Max SPY, including Leaps.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general, and the rules and regulations thereunder, and, in particular, the requirements of Section 6(b) of the Act.[28] In particular, the Exchange believes the proposed rule change is consistent with Section 6(b)(5)[29] requirements that the rules of an exchange [sic] designed to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and in general, to protect investors and the public interest. The Exchange believes that p.m.-settlement for the subject index option in the manner proposed does not raise any meaningful regulatory concerns. Further, the Exchange believes that the proposal will not adversely impact fair and orderly markets on

[28] 15 U.S.C. 78f(b).

[29] 15 U.S.C. 78f(b)(5).

expiration Fridays for the underlying stocks comprising SPY. As discussed in Section (a) of Item 3 of this filing (the purpose section), the handling of orders at the close on the stock markets has matured considerably since concerns were initially raised in the late 1980s. Additionally, the proposed rule change would provide Members and investors with additional opportunities to trade S&P 500® options with a p.m.-settlement feature in an exchange environment and subject to transparent exchange-based rules, and that [sic] investors would also benefit from the opportunity to trade in association with this product on Expiration Fridays thereby removing impediments to a free and open market consistent with the Act.

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.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve or disapprove such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be

disapproved.

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. Please include File Number SR-ISE-2012-22 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-ISE-2012-22. 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 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the

principal office of the Exchange. 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-2012-22 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[30]

Kevin M. O'Neill
Deputy Secretary

---

[30] 17 CFR 200.30-3(a)(12).