SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69175; File No. SR-ISE-2013-17)

March 19, 2013

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Regarding Market Maker Quoting Requirements

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 5, 2013, 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, II, and III below, which items have been prepared by the Exchange. 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 its rules to make changes to market maker quoting requirements. The text of the proposed rule change is available on the Exchange's Web site 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

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

[2] 17 CFR 240.19b-4.

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 proposed rule change is to amend Rule 804 regarding market maker quoting requirements to: (1) eliminate Competitive Market Maker ("CMM") pre-opening obligations; (2) change the CMM quoting requirements to be based on a percentage of time; and (3) specify compliance standards for market maker quoting obligations. All of the proposed changes are consistent with the requirements of other options exchanges. In this respect, the Exchange believes that the current quotation requirements act as a competitive disadvantage that limits its ability to attract liquidity providers to the ISE. Moreover, applying quotation standards that are substantially similar to other options exchanges will remove a significant compliance burden on members who provide liquidity across multiple options exchanges.

Background

There have been a number of recent rule filings from other options exchanges related to market maker quotation requirements that have brought the rules of most other options exchanges substantially in line: the Chicago Board Options Exchange amended its rules relating to continuous electronic quoting requirements in July 2012;[3] the NASDAQ Options Market ("NOM") eliminated its market maker pre-opening obligations in August 2012;[4] and NASDAQ

3 Exchange Act Release No. 67410 (July 11, 2012), 77 FR 42040 (July 17, 2012) (SR-CBOE-2012-064) (the "CBOE Release"). This rule change was effective upon filing pursuant to Section 19(b)(3)(A) of the Act.

4 Exchange Act Release No. 67722 (August 23, 2012), 77 FR 52375 (August 29, 2012) (SR-NASDAQ-2012-095) (the "NOM Release"). This rule change was effective upon filing pursuant to Section 19(b)(3)(A) of the Act.

OMX PHLX ("Phlx") amended its rules to specify that compliance with market maker continuous quoting rules would be determined on a monthly basis.[5] In each of these filings, the exchanges explained how the proposed changes were substantially similar to the requirements of other options exchanges and represented that applying a differing quoting standard placed the exchanges at a competitive disadvantage. ISE now seeks to make similar changes to its rules so that they are substantially similar to other options exchanges.

Current Quotation Requirements

Pursuant to ISE Rule 804(e)(1), Primary Market Makers ("PMMs") must maintain continuous quotations in all of the series of the options classes to which they are appointed. CMMs do not have a minimum number of options classes for which they must enter quotations. Pursuant to ISE Rule 804(e)(2)(ii), a CMM may initiate quoting in options classes to which it is appointed intraday, but only up to the number of appointed options classes for which it participated in the opening rotation on that day. Whenever a CMM enters a quote in an options class to which it is appointed, it must maintain continuous quotations for that series and at least 60% of the series of the options class listed on the Exchange until the close of trading that day. Preferenced CMMs must maintain continuous quotations for 90% of the series. Rule 804 does not define the meaning of "continuous" nor specify any compliance standards associated with the quoting requirements.

CMM Pre-Opening Obligation

The Exchange proposes to eliminate the requirement that CMMs quote before the opening in a minimum number of options classes to put them on par with market makers on

5 Exchange Act Release No. 67700 (August 21, 2012), 77 FR 51835 (August 27, 2012) (the "Phlx Release"). This rule change was effective upon filing pursuant to Section 19(b)(3)(A) of the Act.

other options exchanges that do not have pre-market quoting obligations.[6] As explained above, ISE Rule 804(e)(2)(ii) currently requires CMMs to participate in the opening in at least half of the classes in which it enters quotations on a daily basis. The Exchange proposes to eliminate this requirement so that CMMs are not restricted in the number of options classes they quote during regular trading hours on this basis. As a result, CMMs will not have an obligation to quote any options classes prior to the opening, just as other options exchanges (e.g., Phlx and NOM) do not impose a pre-opening quoting obligation on their electronic market makers.

Exchange market makers have indicated that the Exchange's requirement to participate in the opening for a minimum number of securities is a deterrent to providing liquidity on the ISE. Such market makers have indicated that, unlike other options exchanges such as Phlx and NOM, the current ISE rule restricts the number of option classes in which they enter quotations during regular market hours. Thus, the proposed rule change will level the playing field with respect to pre-opening obligations while encouraging greater liquidity on the ISE during regular trading hours.

Moreover, the Exchange notes that under the current structure of the rule, options classes currently may not have CMM participation in the opening process and that in such cases the PMM provides liquidity when necessary. Accordingly, the proposal will have no impact on the functioning of the ISE's opening process, but will serve to encourage greater liquidity during regular trading hours by allowing CMMs to quote additional options classes. The Exchange further believes that eliminating pre-opening obligations would be pro-competitive in that it will attract more market makers to the Exchange, thereby increasing the amount of liquidity on the ISE.

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6 See NOM Release, supra note 4; and Phlx Rule1014(b)(ii)(D)(1) (continuous quoting requirements do not include a requirement to enter quotes before the opening).

Calculation of CMM Continuous Quotation Requirements

As noted above, currently under ISE Rule 804(e)(2)(iii), once a CMM chooses to enter quotations in an options class, it is required to quote 60% of the series of the options class (90% for preferenced CMMs) until the end of the trading day. The Exchange proposes to modify this requirement to be 60% of the time an options class is open for trading on the Exchange (90% of the time for preferenced market makers). Currently, some options exchanges, such as NYSE Amex and NYSE Arca, apply a 60% minimum quoting requirement as a percentage of time rather than as a percentage of the series of a class.[7] Under the proposal, the Exchange will calculate the percentage of time a market maker quotes by dividing the number of minutes a market maker entered quotes in series of an options class (the numerator) by the total minutes all series of the options class were open for trading on the Exchange (denominator).[8]

The Exchange believes that imposing minimum CMM quoting requirements based on a percentage of series or as a percentage of time achieves the same result in terms of the amount of liquidity being provided by a market maker, but that measuring market maker participation in terms of a percentage time is a more reasonable and fair way of evaluating whether market makers are providing appropriate levels of liquidity to the market. For example, when measured as a percentage of series, a market maker that continuously quoted 80% of the series of an options class for an entire day, except for a 5 minute period where it quoted only 58% of the series, may be deemed in violation of the current minimum quoting requirement, even though such market maker provided more liquidity to the market than a CMM that continuously quoted

7 NYSE Amex Rule 925.1NY(c); and NYSE Arca Rule 6.37B(c).

8 For example, if a market maker quotes an options class that has 150 series all of which opened at 9:30 a.m. the denominator will be 150 x 390 minutes, or 58,500 minutes. The minimum CMM quoting requirement would therefore be 35,100 minutes (60% of 58,500 minutes).

the minimum 60% of the series for the entire day.[9] Accordingly, the Exchange believes that measuring the minimum quoting requirements in terms of a percentage of time, in the same manner as NYSE Amex and NYSE Arca are doing currently, will more fairly achieve the objective of the minimum quoting requirements.

Quotation Compliance Standards

Rule 804 does not currently contain any standards by which compliance with market maker continuous quotation requirements are measured. Specifically, Rule 804 does not provide any guidance on how market makers satisfy their continuous quotation requirements, nor the method by which the Exchange reviews whether a market maker has met its quoting obligations. In contrast, Phlx and CBOE rules specify that market makers must quote 90% of the time to meet their continuous quotation requirements.[10] Many exchanges also have established a time period of one month to determine whether a market maker has met its quoting obligation, stating that compliance with the continuous quoting obligations will be determined collectively across all options classes on a monthly basis.[11] These exchanges' rules also explicitly state that periods where market makers fail to maintain continuous quotes due to technical problems are not considered when determining whether market makers satisfied their quoting obligations.[12] The Exchange proposes to adopt similar provisions under ISE Rule 804.

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9 If an options class has 100 options series, a market maker that quotes 60% of the series continuously for an entire trading day provides liquidity for 60 series x 390 minutes, which equals 23,400 minutes. A market maker that provides liquidity for 80 series for 385 minutes and 58 series for 5 minutes provides liquidity for a total of 31,090 minutes.

10 Phlx Rule 1014(b)(ii)(D); CBOE Rule 1.1(ccc) (as amended by CBOE Release, supra note 3).

11 Phlx Release, supra note 5; NYSE Amex Rule 925.1NY and NYSE Arca Rule 6.37B.

12 Id. Market makers will be required to promptly notify the Exchange of any technical problems that prevent them from maintaining continuous quotes. In normal circumstances, such notification should be made on the same trading day.

Specifically, the Exchange proposes to state in Supplementary Material to Rule 804 that PMMs shall be deemed to have provided continuous quotes pursuant to Rule 804(e)(1) if they provide two-sided quotes for 90% of the time that the Exchange is open for trading.[13] The Exchange further proposes to state that compliance with the PMM and CMM quoting requirements will be applied to all options classes quoted collectively on a daily basis and will be determined on a monthly basis.[14] Further, the Exchange proposes to specify that if a technical failure or limitation of a system of the Exchange prevents a market maker from maintaining, or prevents a market maker from communicating to the Exchange, timely and accurate quotes, the duration of such failure will not be considered in determining whether the market maker has satisfied its quoting obligations. Additionally the proposed text states that the Exchange may consider other exceptions to the continuous quoting obligation based on demonstrated legal or regulatory requirements or other mitigating circumstances. Finally, the Exchange proposes to specify that the CMM continuous quoting requirements do not include adjusted options series or long-term options.[15] All of these proposed changes are consistent with the rules of other options exchanges.[16]

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13 This provision would apply only to PMMs and not to CMMs, as CMMs would no longer have an obligation to continuously quote a minimum number of series under the proposal. To calculate whether a PMM has maintained quotations for at least 90% of the time, the Exchange will divide the total number of minutes a PMM maintained quotations in options series of a class (the numerator) by the total minutes all series of the options class were open for trading on the Exchange (the denominator).

14 Compliance with market maker quoting obligations will be determined on a monthly basis. However, the ability of the Exchange to determine compliance on a monthly basis does not: (1) relieve market makers from their obligation to meet daily quoting requirements in Rule 804; and (2) prohibit the Exchange from bringing disciplinary action against a market maker for failure to meet its daily quoting requirements set forth in Rule 804. The Exchange provides daily reports to market makers to enable them to monitor their compliance with quoting requirements. The Exchange will continue to provide such daily reports and to monitor market maker compliance on a daily basis.

15 Adjusted options series are series wherein, as a result of a corporate action by the issuer

The proposal assures that compliance standards for two-sided quoting will be the same on the ISE as on other options exchanges. The Exchange believes these standards are appropriate, and that applying consistent standards across options exchanges lessens compliance burdens on members and reduces the potential for regulatory arbitrage. Specifically, specifying that PMMs satisfy their quoting obligations if they quote at least 90% of the time will provide clarity and allow PMMs to better monitor whether they are in compliance with their continuous quoting obligations.[17] Moreover, the Exchange believes that applying the quoting requirements for market makers collectively across all options classes and measuring such compliance over a

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of the underlying security, one options contract in the series represents the delivery of other than 100 shares of underlying stock or exchange-traded fund shares. Long-term options are series with a time to expiration of nine (9) months or greater for options on equities and exchange-traded funds, and options with a time to expiration of twelve (12) months or greater for index options. CMMs may choose to quote such series in addition to regular series in the options class, but such quotations will not be considered when determining whether a CMM has met the obligation contained in paragraph (e)(2)(iii). Thus, such series are not included in the denominator nor are any quotes entered in such series included in the numerator when the Exchange calculates the percentage of time a market maker has quoted an options class. <u>See supra</u> note 8 and accompanying text. This exclusion is limited to CMM quoting requirements. The PMM quoting requirements include all series of an appointed options class, including adjusted series and long-term options. A CMM that chooses to quote adjusted series and/or long-term options must meet all of the quoting obligations applicable to CMMs generally, and may be preferenced in such series and receive enhanced allocations pursuant to ISE Rule 713, Supplementary Material .03, only if it complies with the heightened 90% quoting requirement contained in Rule 804(e)(2)(iii).

16 With respect to compliance standards, see CBOE Rule 1.1(ccc); NYSE Arca Rule 6.37B; NYSE Amex Rule 925.1NY; and Phlx Rule 1014(d)(4). With respect to excluding adjusted series and long term options from the CMM quoting obligation, see CBOE Rule 8.7(d)(ii)(B) (requiring market makers to maintain continuous electronic quotes in 60% of the non-adjusted options series that have a time to expiration of less than nine months); NYSE Arca Rule 6.37B, Commentary .01; NYSE Amex Rule 9.25.1NY, Commentary .01; and Phlx Rule 1014(d)(4).

17 <u>See supra</u> note 14.

monthly basis is a fair and more efficient way for the Exchange and market participants to evaluate compliance with market maker continuous quoting requirements.[18]

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934[19] (the "Act") in general, and furthers the objectives of Section 6(b)(5) of the Act[20] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, 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. All of the proposed changes are consistent with standards currently in place at other options exchanges. As such, the proposed change conform ISE market maker obligations to the requirements of competing markets, which will promote the application of consistent trading practices across markets that provide market makers with similar benefits. In this respect, the Exchange notes that CBOE, Phlx and NYSE Amex all have market structures that allocate trades to market makers in a manner similar to the ISE.[21] However, the Exchange also notes that the same market maker obligations currently are being applied on competitive exchanges to options classes traded in a price-time market structure (such as Arca). While these different markets and market structures

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18 On the basis of the daily reports, the Exchange will continue to inform market makers if they are failing to achieve their quoting requirements. Moreover, on the basis of daily monitoring activity, the Exchange can determine whether market makers violated any other Exchange rules such as, for example, Rule 400 regarding just and equitable principles of trade. Such daily monitoring will allow the Exchange to investigate unusual activity and to take appropriate regulatory action.

19 15 U.S.C. 78f(b).

20 15 U.S.C. 78f(b)(5).

21 See, e.g., CBOE Rule 6.45A and NYSE Amex Rule 964NY.

may provide slightly different benefits to market makers, the Exchange does not believe these differences are sufficient to out-weigh the significant existing competitive burden applying more stringent quotation requirements places on the Exchange.

Specifically, with respect to the proposal to eliminate the requirement that CMMs quote before the opening in a minimum number of options classes, the Exchange believes that the proposal removes a requirement that is unnecessary, as evidenced by the fact that it does not exist on other competitive markets. The Exchange operates in a highly competitive market comprised of eleven U.S. options exchanges in which sophisticated and knowledgeable market participants can, and do, send order flow and/or provide liquidity to competing exchanges if they deem trading practices at a particular exchange to be onerous or cumbersome. With this proposal, ISE market makers will be relieved of a requirement that limits their ability to provide liquidity during regular market hours and places a burden upon them that does not exist on other competitive markets with similar market structures. The Exchange believes that eliminating pre-opening quoting obligations will attract more CMMs to the Exchange, thereby increasing competition and liquidity on the ISE.

With respect to the proposal to base the CMMs minimum quotation requirements on a percentage of time rather than as a percentage of series, the Exchange believes that that measuring market maker participation in terms of a percentage of time is a more reasonable and fair way of evaluating whether market makers are providing appropriate levels of liquidity to the market. Moreover, the Exchange believes that measuring the minimum quoting requirements in terms of a percentage of time, as NYSE Amex and NYSE Arca are doing currently, will provide a better measure of the level of liquidity being provided by market makers.

Finally, with respect to compliance standards, the Exchange believes that adopting the proposed standards will enhance compliance efforts by market makers and the Exchange, and are consistent with the requirements currently in place on other exchanges. The proposal ensures that compliance standards for continuous quoting will be the same on the Exchange as on other options exchanges, and the proposal to exclude adjusted series and long-term options from the CMM continuous quoting requirements assures that the quotation requirements are being applied similarly across exchanges, such as the CBOE, Phlx, NYSE Amex and NYSE Arca.[22]

While under the proposal the quoting requirements are changing, the Exchange does not believe that these changes reduce the overall obligations applicable to market makers. In this respect, the Exchange notes that such market makers are subject to many obligations, including the obligation to maintain a fair and orderly market in their appointed classes, which the Exchange believes eliminates the risk of a material decrease in liquidity. In addition to this and other requirements applicable to market maker quotations under Rules 803 and 804, PMMs continue to have an obligation to conduct the opening and enter continuous quotations in all of the series of their appointed options classes and to do so within maximum spread requirements. CMMs have an obligation to maintain continuous quotes for at least 60% of the time the options

[22] See supra note 16. In this respect, the Exchange notes that NYSE Arca and NYSE Amex exclude adjusted series and long-term options from the quoting requirements for all market makers, including those markets' equivalent of the ISE's PMMs. For quote mitigation purposes, Arca only disseminates quotes in active options series. NYSE Arca Rule 6.86, Commentary .03, and NYSE Amex Rule 970.1NY. The ISE, however, has not implemented a similar approach to quote mitigation. Rather, the ISE disseminates quotations in all options series listed on the exchange, and pursuant to ISE Rule 804(e)(1) the ISE requires PMMs to maintain continuous quotations in all listed series of their appointed options classes, including adjusted series and long-term options. Thus, the Exchange does not believe that it is necessary to require CMMs to quote such series, and that it is appropriate to exclude such options series from the CMM quoting requirements contained in ISE Rule 804(e)(ii) in the interest of applying consistent standards across exchanges for non-specialist market makers, such as CBOE and Phlx, as well as NYSE Arca and NYSE Amex. See supra note 16.

class is open for trading on the Exchange (as opposed to 60% of the series), and to do so within maximum spread requirements. Preferenced market makers will continue to have a heighted quotation requirement, as they are required to maintain continuous quotes for at least 90% of the time the options class is open for trading on the Exchange (as opposed to 90% of the series) and to do so within maximum spread requirements. Additionally, CMMs will continue to be obligated to enter quotes whenever, in the judgment of an Exchange official, it is necessary to do so in the interest of fair and orderly markets.[23] Accordingly, the benefits the proposed rule change confers upon market makers are offset by the continued responsibilities to provide significant liquidity to the market to the benefit of market participants.

For the foregoing reasons, the Exchange believes that the balance between the benefits provided to market makers and the obligations imposed upon market makers by the proposed rule change is appropriate.

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

The Exchange believes that the current quotation requirements act as a competitive disadvantage that limits the ISE's ability to attract liquidity providers. The proposal is comparable to current rules at competing options exchanges related to market-maker continuous quoting obligations and will ensure fair competition among the options exchange that provide market makers with similar benefits. Accordingly, the Exchange believes that the proposal will enable the Exchange to attract additional CMMs, thereby increasing competition and liquidity on the ISE.

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[23] ISE Rule 804(e)((2)(iv).

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

Because the foregoing proposed rule change does not significantly affect the protection of investors or the public interest, does not impose any significant burden on competition, and, 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, it has become effective pursuant to Section 19(b)(3)(A)[24] of the Act and Rule 19b-4(f)(6)[25] thereunder. The Exchange provided the Commission with 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 the proposed rule change.

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:

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[24] 15 U.S.C. 78s(b)(3)(A).

[25] 17 C.F.R. 240.19b-4(f)(6).

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-2013-17 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-2013-17. 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, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such 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-2013-17 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.[26]

Kevin M. O'Neill
Deputy Secretary

[26] 17 CFR 200.30-3(a)(12).