

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70644; File No. SR-Topaz-2013-06)

October 9, 2013

Self-Regulatory Organizations; Topaz Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Market Maker Risk Parameters

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 September 30, 2013, the Topaz Exchange, LLC (d/b/a ISE Gemini) (the "Exchange" or "Topaz") 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 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 changes to mitigate market maker risk by requiring market makers to enter values in the Exchange-provided risk parameters.

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.

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

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, Proposed Rule Change

1. Purpose

Pursuant to Topaz Rule 804, the Exchange currently provides functionality that will automatically remove a market maker's quotes in all series of an options class when certain parameter settings are triggered. Specifically, there are four parameters that can be set by market makers on a class-by-class basis. These parameters are available for market maker quotes in single options series. Market makers establish a time frame during which the system calculates: (1) the number of contracts executed by the market maker in an options class; (2) the percentage of the total size of the market maker's quotes in the class that has been executed; (3) the absolute value of the net between contracts bought and contracts sold in an options class; and (4) the absolute value of the net between (a) calls purchased plus puts sold, and (b) calls sold plus puts purchased. The market maker establishes limits for each of these four parameters, and when the limits are exceeded within the prescribed time frame, the market makers quotes are removed.³

The purpose of this functionality is to allow market makers to provide liquidity across potentially hundreds of options series without being at risk of executing the full cumulative size

³ The Exchange is proposing certain non-substantive changes to the text of Rule 804 for clarity. The changes shorten the first sentence in Rule 804 by deleting "if the market maker trades, in the aggregate across all series of an options class during a specified time period" and to delete "(established by the market maker), within a time frame specified by the market maker" as the text might be confusing in its current form and is redundant with other text within the Rule. To assure clarity, the Exchange also proposes to specify that the first parameter is a number of "total" contracts "in the class," and to specify that the fourth parameter is a net value based on puts and calls purchased and sold "in the class." Finally, the Exchange proposes to use a uniform construction of "the specified ..."

of all such quotes before being given adequate opportunity to adjust their quotes. For example, if a market maker can enter quotes with a size of 20 contracts in 150 series of an options class, its total potential exposure is 3000 contracts in the options class. To mitigate the risk of executing all 3000 contracts without evaluating its positions, the market maker risk functionality will automatically remove its quotes in all series of the options class after it has executed a specified number of contracts (e.g., 100) in series of that options class during a specified time period (e.g., 5 seconds).

To assure that all quotations are firm for their full size, the parameter calculations occur after an execution against a market maker's quote takes place. For example, if a market maker has set a parameter of 100 contracts during a 5 second interval for an options class, and has executed a total of 95 contracts in the options class within the previous 3 seconds, a quote in a series of that class with a size of 20 contracts continues to be firm for all 20 contracts. In this example, an incoming order could execute all 20 contracts of the quote, and following the execution, the total size parameter would add 20 contracts to the running total of 95. Since the total size executed within the 5 second time frame exceeds the 100 contracts established by the market maker for the options class, all of the market maker's quotes in the options class would be removed. The market maker would then enter new quotes in the class.

Use of these risk management tools is voluntary under the rules. Similarly, from a technical perspective, market makers currently do not need to enter any values into the applicable fields, and thus effectively can choose not to use these tools. The Exchange proposes

for each of the four parameters. The Exchange is not proposing to alter the operation of the functionality, other than to make use of the parameters mandatory.

to amend the rule to make it mandatory for market makers to enter values into all four of the quotation risk management parameters for all options classes in which it enters quotes. The purpose of the rule change is to prevent market makers from inadvertently entering quotes without risk-management parameters. In this respect, the Exchange notes that all Topaz market makers currently use the parameters when entering quotes.⁴ However, it is possible that a market maker could inadvertently enter quotes without populating one or more of the risk parameters, resulting in the member being exposed to much more risk than it intended. Accordingly, at the request of Topaz market makers, the Exchange proposes to modify the trading system to reject quotes if there are any missing risk management values for the options class.

While entering values into the quotation risk parameters will be mandatory to prevent an inadvertent exposure to risk, the Exchange notes that market makers who prefer to use their own risk-management systems can enter values that assure the Exchange-provided parameters will not be triggered.⁵ Accordingly, the proposal does not require members to manage their risk using the Exchange-provided tools.

⁴ The Exchange notes that with the exception of one market maker, all Topaz market makers are currently also market makers on the International Securities Exchange (“ISE”) and ISE recently amended its rules to make it mandatory for market makers to enter values into all four risk management parameters for classes in which ISE market makers enter quotes. Topaz market makers are therefore accustomed to using these risk parameters because they are required to use them when trading on ISE. The Exchange therefore does not believe the proposed rule change will have any impact on the way members currently trade on the Exchange. Additionally, the Exchange will provide notice to members before making use of the parameters mandatory.

⁵ For example, a market maker could set the value for the total number of contracts executed in a class at a level that exceeds the total number of contracts the market maker actually quotes in an options class.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the “Act”)⁶ in general, and furthers the objectives of Section 6(b)(5) of the Act⁷ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and 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 requiring market makers to enter values into the risk parameters provided by the Exchange will not be unreasonably burdensome, as all Topaz market makers currently utilize the functionality. Moreover, the Exchange is proposing this rule change at the request of its market makers to reduce their risk of inadvertently entering quotes without populating the risk parameters. As discussed above, the Exchange will be modifying the trading system to automatically reject quotations unless the parameters are populated with values, which will protect market makers from inadvertent exposure to excessive risk. Reducing such risk will enable market makers to enter quotations with larger size, which in turn will benefit investor through increased liquidity for the execution of their orders. Such increased liquidity benefits investors because they receive better prices and because it lowers volatility in the options market.

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

The proposed rule change does not impose any burden on competition. This proposal is based on a recently approved rule change by the International Securities Exchange, LLC (“ISE”) and is identical to the ISE proposal.⁸ The proposed rule change to make it mandatory for market

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

⁸ See Securities Exchange Act Release No. 70132 (August 7, 2013), 78 FR 49311 (August 13, 2013) (SR-ISE-2013-38).

makers to populate the quotation risk management parameters is being made at the request of Topaz market makers to prevent the inadvertent entry of quotes without risk-management parameters. Market makers who prefer to use their own risk-management systems can enter out-of-range values so that the Exchange-provided parameters will not be triggered. Accordingly, the proposal does not require members to manage their risk using an Exchange-provided tool.

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

The Exchange believes that the foregoing proposed rule change may take effect upon filing with the Commission pursuant to Section 19(b)(3)(A)⁹ of the Act and Rule 19b-4(f)(6) thereunder¹⁰ because the foregoing proposed rule change does not (i) significantly affect the protection of investors or the public interest, (ii) impose any significant burden on competition, and (iii) become operative for 30 days after its filing date, or such shorter time as the Commission may designate.

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: (i) necessary or appropriate in the public interest; (ii) for the protection of investors; or

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file 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. The Exchange has satisfied this requirement.

(iii) otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or 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-Topaz-2013-06 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-Topaz-2013-06. 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 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-Topaz-2013-06 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.¹¹

Kevin M. O'Neill
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).