

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70059; File No. SR-ISE-2013-42)

July 29, 2013

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change to List Options on the Nations VolDex Index

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 17, 2013, the International Securities Exchange, LLC (“Exchange” or “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 proposes to amend its rules for the listing and trading on the Exchange of options on the Nations VolDex index, a new index that measures changes in implied volatility of the SPDR<sup>®</sup> S&P<sup>®</sup> ETF. The Exchange also proposes to list and trade long-term options on the Nations VolDex index. Options on the Nations VolDex index will be cash-settled and will have European-style exercise provisions. The text of the proposed rule change is available on the Exchange’s Web site [www.ise.com](http://www.ise.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

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

<sup>2</sup> 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 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 Exchange proposes to amend its rules to provide for the listing and trading on the Exchange of options on a new index that measures changes in implied volatility of the SPDR<sup>®</sup> S&P<sup>®</sup> Exchange Traded Fund (ETF) (commonly known and referred to by its ticker symbol, SPY). Options on the Nations VolDex index (the "Index") will be cash-settled and will have European-style exercise provisions. In addition to regular options, the Exchange proposes to also list long-term options on the Index. The Index is calculated using published real-time bid/ask quotes of SPY options. The Index represents annualized implied volatility and is quoted in percentage points.

#### Index Design and Composition

The calculation of the Index is based on the methodology developed by NationsShares, a firm that develops proprietary derivatives-based indexes and options-enhanced indexes. The Index will be calculated and maintained by a calculation agent acting on behalf of NationsShares. The Index reflects changes in implied volatility of SPY, historically the largest

and most actively traded ETF in the United States as measured by its assets under management and the value of shares traded.

The Index measures the implied volatility of a hypothetical 30-day at-the-money (ATM) SPY put option, by interpolating the prices of synthetic put options that are precisely ATM.<sup>3</sup> The options used in the calculation of the Index are the published first in-the-money (ITM) and the first out-of-the-money (OTM) put options in the front month (i.e., nearest monthly expiration) and second month expirations (i.e., second nearest monthly expiration). Front month options must have at least one week to expiration. On the open of trading on the first business day of a regular option expiration week (i.e., for standard monthly expirations), the options used for the Index will “roll” to the next regular expiration month and the following expiration month. The prices used in the calculation of the Index will be the mid-point of the published consolidated bid/ask quote (i.e., the NBBO) in SPY options.

The generalized formula for the Index is:

$$Nations VolDex = 100 \times \frac{(43,200 - T_1) \times (IV_2 - IV_1)}{(T_2 - T_1)} + IV_1$$

Where:

- 43,200 is the number of minutes in 30 days;
- $T_1$  is time to expiration of the Front Month options in minutes;
- $T_2$  is time to expiration of the Second Month options in minutes;
- $IV_1$  is the implied volatility of the Front Month precisely ATM SPY put option;
- $IV_2$  is the implied volatility of the Second Month precisely ATM SPY put option.

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<sup>3</sup> For the purpose of this rule filing, the term “precisely at-the-money” refers to a hypothetical option and strike price.

The implied volatilities of the precisely ATM SPY put options are derived using a three-step process. The first step is to calculate the forward prices for both the front and second month expirations. This is accomplished by evaluating the absolute difference between the call and put option premium at each strike price and identifying the strike price where that absolute difference is the smallest. The forward price is calculated by adding the strike price to the present value of the published call price minus the published put price. The second step is to interpolate the precisely ATM put option price for both the front month and second month expirations. This is accomplished by using each respective month's forward price, the first ITM strike, the first OTM strike, the first ITM put price, and the first OTM put price. The final step is to calculate the implied volatility for the precisely ATM put option for each respective month using the forward price and the precisely ATM put option for that month.

The SPDR<sup>®</sup> S&P<sup>®</sup> ETF is the largest and most actively traded ETF in the U.S.<sup>4</sup> According to State Street Global Advisor, the Trustee of SPY, as of June 20, 2013, the net assets under management in SPY was approximately \$106.8 billion; the weighted average market capitalization of the portfolio components was approximately \$106 billion; the smallest market capitalization was approximately \$2.1 billion (Apollo Group Inc., ticker: APOL), and the largest was approximately \$395.9 billion (ExxonMobil, ticker: XOM).<sup>5</sup>

For the three months ending June 20, 2013, the average daily volume in SPY shares was 137 million, and the average value of shares traded was \$22.1 billion.<sup>6</sup> For the same period, the

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<sup>4</sup> The SPDR<sup>®</sup> S&P<sup>®</sup> ETF holds up to 500 securities listed on U.S. securities exchanges.

<sup>5</sup> See <https://www.spdrs.com/product/fund.seam?ticker=SPY>

<sup>6</sup> Calculated using data from Bloomberg as of June 20, 2013.

average daily volume in SPY options was approximately 2.8 million contracts.<sup>7</sup> Open interest in SPY options was approximately 25.2 million contracts.<sup>8</sup>

As set forth in Exhibit 3-1, following are the characteristics of the Index: (i) the initial index value was 11.49 on January 31, 2005; (ii) the index value on June 20, 2013 was 18.73; (iii) the lowest index value since inception was 8.83 and occurred on January 24, 2007; and (iv) the highest index value since inception was 77.98 and occurred on October 10, 2008.

#### Index Calculation and Maintenance

As noted above, the Index will be maintained and calculated by a calculation agent acting on behalf of NationsShares. The level of the Index will reflect the current implied volatility of SPY. The Index will be updated on a real-time basis on each trading day beginning at 9:30 a.m. and ending at 4:15 p.m. (New York time). If the current published value of a component is not available, the last published value will be used in the calculation.

Values of the Index will be disseminated every 15 seconds during the Exchange's regular trading hours to market information vendors such as Bloomberg and ThomsonReuters. In the event the 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 Index will expire on the Wednesday that is thirty days prior to the third Friday of the calendar month immediately following the expiring month. Trading in expiring options on the Index will normally cease at 4:15 p.m. (New York time) on the Tuesday preceding

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<sup>7</sup> Calculated using data from The Options Clearing Corp. as of June 20, 2013.

<sup>8</sup> Calculated using data from Bloomberg as of June 20, 2013.

an expiration Wednesday. The exercise and settlement value will be calculated on Wednesday at 9:30 a.m. (New York time) using the mid-point of the NBBO for the SPY options used in the calculation of the Index at that time. The exercise-settlement amount is equal to the difference between the settlement value and the exercise price of the option, multiplied by \$100. Exercise will result in the delivery of cash on the business day following expiration.

### Contract Specifications

The contract specifications for options on the Index are set forth in Exhibit 3-2. The Index is a broad-based index, as defined in Rule 2001(k). Options on the Index are European-style and cash-settled. The Exchange's standard trading hours for index options (9:30 a.m. to 4:15 p.m., New York time) will apply to the Index. The Exchange proposes to apply margin requirements for the purchase and sale of options on the Index that are identical to those applied for its other broad-based index options.

The trading of options on the Index will be subject to the trading halt procedures applicable to other index options traded on the Exchange.<sup>9</sup> Options on the Index will be quoted and traded in U.S. dollars.<sup>10</sup> Accordingly, all Exchange and Options Clearing Corporation members shall be able to accommodate trading, clearance and settlement of the Index without alteration.

The Exchange proposes to set the minimum strike price interval for options on the Index at \$1 or greater, as long as the strike price is below \$200, in accordance with proposed ISE Rule 2009(c)(7). The Exchange believes that \$1 strike price intervals will provide investors with greater flexibility by allowing them to establish positions that are better tailored to meet their investment objectives. Further, as proposed, when new series of options on the Index with a new

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<sup>9</sup> See ISE Rule 2008(c).

<sup>10</sup> See ISE Rule 2009(a)(1).

expiration date are opened for trading, or when additional series of options on the Index in an existing expiration date are opened for trading as the current value of the Index moves substantially from the exercise prices of series already opened, the exercise prices of such new or additional series shall be reasonably related to the current value of the Index at the time such series are first opened for trading.<sup>11</sup> The Exchange, however, proposes to eliminate this range limitation that will limit the number of \$1 strikes that may be listed in options on the Index. The Exchange's proposal to set minimum strike price intervals without a range limitation is identical to strike price intervals adopted by CBOE for the CBOE Volatility Index.<sup>12</sup>

The Exchange proposes to adopt minimum trading increments for options on the Index to be \$0.05 for series trading below \$3, and \$0.10 for series trading at or above \$3.

The Exchange proposes to list options on the Index in the three consecutive near-term expiration months plus up to three successive expiration months in the March cycle. For example, consecutive expirations of January, February, March, plus June, September, and December expirations would be listed.<sup>13</sup>

The Exchange proposes that there shall be no position or exercise limits for options on the Index. As noted above, the Index will settle using published quotes from its corresponding option, specifically SPY options. Given that there are currently no position limits for SPY options,<sup>14</sup> the Exchange believes it is appropriate for there to be no position or exercise limits for

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<sup>11</sup> See ISE Rule 2009(c)(3). The term "reasonably related to the current index value of the underlying index" means that the exercise price is within thirty percent (30%) of the current index value, as defined in ISE Rule 2009(c)(4).

<sup>12</sup> See Securities Exchange Act Release No. 63155 (October 21, 2010), 75 FR 66402 (October 28, 2010) (SR-CBOE-2010-096).

<sup>13</sup> See Rule 2009(a)(3).

<sup>14</sup> See Securities Exchange Act Release No. 68000 (October 5, 2012), 77 FR 62300 (October 12, 2012) (SR-ISE-2012-81).

options on the Index. Because the size of the market underlying SPY options is so large, ISE believes that this should dispel any concerns regarding market manipulation. By extension, ISE believes that the same reasoning applies to options on the Index since the value of options on the Index is derived from the volatility of SPY as implied by its options. The Exchange notes that options on CBOE's Volatility Index are also not subject to any position or exercise limits.<sup>15</sup>

The trading of options on the Index shall be subject to the same rules that presently govern the trading of Exchange index options, including sales practice rules, margin requirements, and trading rules. In addition, long-term option series having up to sixty months to expiration may be traded.<sup>16</sup> The trading of long-term options on the Index 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. Further, pursuant to Supplementary Material .01 and .02 to ISE Rule 2009, the Exchange may also list Short Term Option Series and Quarterly Options Series, respectively, on the Index.

Chapter 6 of the Exchange's rules is designed to protect public customer trading and shall apply to trading in options on the Index. Specifically, ISE Rules 608(a) and (b) prohibit Members from accepting a customer order to purchase or write an option, including options on the Index, unless such customer's account has been approved in writing by a designated Options Principal of the Member.<sup>17</sup> Additionally, ISE's Rule 610 regarding suitability is designed to ensure that options, including options on the Index, are only sold to customers capable of

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<sup>15</sup> See Securities Exchange Act Release No. 54019 (June 20, 2006), 71 FR 36569 (June 27, 2006) (SR-CBOE-2006-55). Additionally, the Exchange notes there are currently a number of actively-traded broad-based index options, i.e., DJX, NDX, SPX, that are also not subject to any position or exercise limits.

<sup>16</sup> See Rule 2009(b)(1).

<sup>17</sup> Pursuant to ISE Rule 602, Representatives of a Member may solicit or accept customer orders for options on the Index.



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, including options on the Index, 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, including discretionary orders for options on the Index, on the day the discretionary order is entered. Finally, ISE Rule 609, Supervision of Accounts, Rule 612, Confirmation to Customers, and Rule 616, Delivery of Current Options Disclosure Documents and Prospectus, will also apply to trading in options on the Index.

Finally, a trading license issued by the Exchange will be required for all market makers to effect transactions as a market maker in the Index in accordance with ISE Rule 2013.

#### Surveillance and Capacity

The Exchange has an adequate surveillance program in place for options traded on the Index and intends to apply those same program procedures that it applies to the Exchange's other options products. Further, 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. Additionally, the Exchange is also a member of the Intermarket Surveillance Group (ISG) under the Intermarket Surveillance Group Agreement, dated June 20, 1994. The members of the ISG include all of the U.S. registered stock and options markets: NYSE MKT LLC, NYSE Arca, Inc., BATS Exchange,

Inc., NASDAQ OMX BX, Chicago Board Options Exchange, Inc., Chicago Stock Exchange, Inc., Financial Industry Regulatory Authority, NASDAQ Stock Market LLC, National Stock Exchange, Inc., the New York Stock Exchange LLC, and NASDAQ OMX PHLX, Inc. The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets.

The Exchange represents that it has the necessary system capacity to support additional quotations and messages that will result from the listing and trading of options on the Index.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934 (the “Act”)<sup>18</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>19</sup> in particular in that it will permit options trading in the Index pursuant to rules designed to prevent fraudulent and manipulative acts and practices and promote just and equitable principles of trade. In particular, the Exchange believes the proposed rule change will further the Exchange’s goal of introducing new and innovative products to the marketplace. The Exchange believes that listing options on the Index will provide an opportunity for investors to hedge, or speculate on, the market risk associated with changes in implied volatility.

Volatility-focused products have become more prominent over the past few years, and in a number of different formats and types, including ETFs, exchange-traded notes, exchange-traded options, and exchange-traded futures. Such products offer investors the opportunity to manage their volatility risks associated with an underlying asset class. Currently, most of the products focus on underlying equity indexes or equity-based portfolios. The Exchange proposes

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<sup>18</sup> 15 U.S.C. 78f(b).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

to introduce a cash-settled options contract on a new volatility index, which focuses on equity exposure using options on the SPDR<sup>®</sup> S&P<sup>®</sup> ETF (SPY). SPY is the largest and most liquid ETF in the United States, and the most actively traded equity option product. The Exchange believes that because the Index is derived from published SPY options prices, and given the immense liquidity found in the individual portfolio components of SPY, the concern that the Index will be subject to market manipulation is greatly reduced. Therefore, the Exchange believes that the proposed rule change to list options on the Index is appropriate.

The Exchange further notes that ISE Rules that apply to the trading of other index options currently traded on the Exchange would also apply to the trading of options on the Index. Additionally, the trading of options on the Index would be subject to, among others, Exchange Rules governing margin requirements and trading halt procedures.

Finally, the Exchange represents that it has an adequate surveillance program in place to detect manipulative trading in options on the Index. The Exchange also represents that it has the necessary systems capacity to support the new options series. And as stated in the filing, the Exchange has rules in place designed to protect public customer trading.

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

This proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange notes that the proposed rule change will facilitate the listing and trading of a novel index option product that will enhance competition among market participants, to the benefit of investors and the marketplace.

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](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2013-42 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-2013-42. 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-2013-42 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.<sup>20</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).