

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-72399; File No. SR- ISE-2014-31)

June 16, 2014

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of a Proposed Rule Change on Bid/Offer Differentials for In-The-Money Option Series

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 June 4, 2014, the International Securities Exchange, LLC (“Exchange” or “ISE”) filed with the Securities and Exchange Commission (“SEC” or “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 ISE proposes to amend its rules to require that market makers quoting certain in-the-money options series maintain quotes that are no wider than the spread between the NBBO in the underlying security. The text of the proposed rule change is available on the Exchange’s website (<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 self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments

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

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

it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to amend Rule 803(b)(4)(i) to require that market makers quoting certain in-the-money options series maintain quotes that are no wider than the spread between the national best bid and offer (“NBBO”) in the underlying security. The Exchange believes that requiring that market makers post tighter quotes in these option series will improve market quality to the benefit of investors that trade on the ISE.

In the course of maintaining fair and orderly markets in appointed options classes, market makers are generally required to price options contracts fairly by, among other things, bidding and offering so as to create differences of no more than \$5 between the bid and offer following the opening rotation in an options contract.<sup>3</sup> In addition, Rule 803(b)(4)(i) presently permits market makers to submit quotes with wider bid/offer differentials for in-the-money options series where the market for the underlying security is wider than the market maker’s regular quotation requirements. In particular, a market maker quoting an in-the-money options series may submit quotes that are as wide as the quotation on the primary market of the underlying security. For example, if the primary market for ABC has a quote of \$65 (bid) - \$73 (offer), ISE market

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<sup>3</sup> See Rule 803(b). Unless the ISE establishes wider differentials for specific option classes, bid/offer differentials prior to the opening rotation must be no more than \$0.25, \$0.40, \$0.50, \$0.80, or \$1, with the larger bid/offer differentials permitted for option contracts with higher priced bids. Id.

makers may quote in-the-money option series on that security with a bid/offer differential of \$8. The wider bid/offer differentials allowed in these circumstances are intended to give market makers more flexibility with respect to their quoting obligations as options are priced relative to the price of the underlying security.

The Exchange proposes to change this obligation to instead require that market makers quoting these in-the-money options series maintain quotes that are no wider than the spread between the NBBO in the underlying security. A market maker quoting an in-the-money options series can hedge its position by trading in the underlying security at the NBBO, which may be narrower than the quotation on the primary market. For instance, in the example above, other exchanges that trade ABC may collectively have a higher bid of \$66 and a lower offer of \$72. Under the proposed rule, ISE market makers would be required to quote in-the-money option series on ABC with a bid/offer differential of no more than \$6. The Exchange believes that measuring the permissible width of a market maker's quote against the NBBO more accurately reflects the current trading environment where multiple trading venues contribute to the prevailing market price of a security underlying an options series traded on the ISE.

## 2. Basis

The Exchange believes that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b) of the Act.<sup>4</sup> In particular, the proposal is consistent with Section 6(b)(5) of the Act,<sup>5</sup> because is designed to promote just and

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<sup>4</sup> 15 U.S.C. 78f(b).

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

equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest.

This change is designed to benefit investors, who will be able to trade at better prices due to narrower spreads in in-the-money option series covered by the proposed rule change. The Exchange believes that market makers should maintain quotes that are no wider than the spread between the NBBO in the underlying security, as they can hedge their positions by trading in the underlying security at the NBBO, which may be narrower than the quotation on the primary market. As explained above, the Exchange believes that measuring the permissible width of a market maker's quote against the NBBO more accurately reflects the current trading environment where multiple trading venues contribute to the prevailing market price of a security underlying an options series traded on the ISE.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change is intended to encourage tighter markets in in-the-money option series and is not designed to have any competitive impact. While market makers may be required to narrow their quotes in these series, the proposed rule change still affords sufficient flexibility to allow market makers to do so while managing their risk by hedging in the underlying security at the NBBO.

(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 up to 90 days (i) as the Commission may designate 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-2014-31 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-ISE-2014-31. 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 ISE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to

File Number SR-ISE-2014-31 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>6</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>6</sup> 17 CFR 200.30-3(a)(12).