

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67083; File No. SR-ISE-2012-33)

May 31, 2012

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change Regarding Strike Price Intervals for Certain Option Classes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 21, 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 proposes to amend its rules to modify the Short Term Option Series Program (“STOS Program”) to permit, during the expiration week of an option class that is selected for the STOS Program, the strike price intervals for the related non-STOS options to be the same as the strike price interval for the STOS options. The Exchange also proposes to adopt a rule to open for trading Short Term Option Series at \$0.50 strike price intervals for option classes that trade in one dollar increments and are in the STOS Program.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 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 this proposed rule change is to amend ISE Rules 504 and 2009 regarding the STOS Program.³ Specifically, the Exchange proposes to amend its rules to indicate that during the expiration week of an option class that is selected for the STOS Program, the strike price intervals for the related non-STOS option⁴ shall be the same as the strike price interval for the STOS option. The purpose of this proposed rule change is also to adopt a rule to permit the Exchange to list Short Term Option Series at \$0.50

³ The Exchange adopted the STOS Program on a pilot basis in 2005. See Securities Exchange Act Release No. 52012 (July 12, 2005), 70 FR 41246 (July 18, 2005) (SR-ISE-2005-17). The STOS Program was approved on a permanent basis in 2010. See Securities Exchange Act Release No. 62444 (July 2, 2010), 75 FR 39595 (July 9, 2010) (SR-ISE-2010-72).

⁴ The related non-STOS option will be the same option class as the STOS option but will have a longer expiration cycle (e.g., a SPY monthly option as compared to a SPY weekly option.)

strike price intervals for option classes that trade in one dollar increments and are in the STOS Program (“Eligible Option Classes”). As of April 13, 2012, there are 95 Eligible Option Classes.⁵

The STOS Program is codified in ISE Rules 504 and 2009. These rules state that after an option class has been approved for listing and trading on the Exchange, the Exchange may open for trading on any Thursday or Friday that is a business day series of options on no more than thirty option classes that expire on the Friday of the following business week that is a business day. In addition to the thirty-option class limitation, there is also a limitation that no more than twenty series for each expiration date in those classes that may be opened for trading.⁶ Furthermore, the strike price of each short term option has to be fixed with approximately the same number of strike prices being opened above and below the value of the underlying security at about the time that the short term options are initially opened for trading on the Exchange, and with strike prices being

⁵ As of April 13, 2012, there are 141 option classes across all options exchanges that have STOS options expiring on April 13, 2012. Of these 141 option classes, only 95 would qualify to have series listed at \$0.50 strikes because these 95 classes currently trade in one dollar increments and are selected to participate in the STOS Program.

⁶ The Exchange may open up to 10 additional series for each option class that participates in the Short Term Option Series Program when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying security moves substantially from the exercise price or prices of the series already opened. Any additional strike prices listed by the Exchange shall be within thirty percent (30%) above or below the current price of the underlying security. The Exchange may also open additional strike prices on Short Term Option Series that are more than 30% above or below the current price of the underlying security provided that demonstrated customer interest exists for such series, as expressed by institutional, corporate or individual customers or their brokers. Market makers trading for their own account shall not be considered when determining customer interest under this provision. Supplementary Material .02(d) to Rule 504 and Supplementary Material .01(d) to Rule 2009.

within thirty percent (30%) above or below the closing price of the underlying security from the preceding day. The Exchange does not propose any changes to the current program limitations. The Exchange only proposes to specify that Eligible Option Classes can have interval prices of \$0.50, as proposed under Supplementary Material .12 to Rule 504 and Supplementary Material .05 to Rule 2009.

The principal reason for the proposed interval pricing structure is market and customer demand. The Exchange has received numerous requests to list actively traded products, such as the Eligible Option Classes, in more granular strike price intervals, especially as they approach expiration to provide Members and their customers more trading opportunities for short term options.

In the almost two years since the inception of the STOS Program, it has steadily expanded to the point that in the 1st quarter of 2012, STOS options represented 9.0% of the total options volume on the Exchange and 9.2% of the total options volume in the United States. The STOS options volume becomes even more significant when the volume of an STOS option class is compared to the volume of the related non-STOS option class. As an example, in the first three months of 2012, on the Exchange there were 10,399,842 contracts of SPY STOS options traded and 18,354,779 contracts of SPY monthly options traded; and 1,319,580 contracts of AAPL STOS options traded and 3,975,896 contracts of AAPL monthly options traded. From the 4th quarter of 2010 to the 4th quarter of 2011, STOS options volume increased by more than 40%,⁷ and the Exchange believes that STOS options volume will continue to rise as a percentage of overall activity in 2012.

⁷ During the same time period, monthly options volume decreased by 8%.

Moreover, the Commission has previously approved the use of \$0.50 strike price intervals. Numerous options products are listed (trade) on the Exchange at \$0.50 strike price intervals. For example, pursuant to ISE Rule 504(h), there are six individual ETF options listed on the Exchange at \$0.50 strike price intervals. There are approximately 53 options listed on the Exchange at \$0.50 strike price intervals pursuant to the \$0.50 Strike Program. The Exchange further notes that while there are more than 1,000 options listed on the Exchange with one dollar strike price intervals, under this proposed rule change, the Exchange would currently offer only 95 option classes in more granular strike intervals.⁸

The Exchange believes that there are substantial benefits to market participants in the ability to trade the Eligible Option Classes at more granular strike price intervals. The proposed interval for the Eligible Option Classes would allow traders and investors, and in particular public (retail) investors to more effectively and with greater precision consummate trading and hedging strategies on the Exchange. The Exchange believes that this precision is increasingly necessary, and in fact crucial, as traders and investors engage in trading and hedging strategies across various investment platforms (e.g., equity and ETF, index, derivatives, futures, foreign currency, and even commodities products);

⁸ The Exchange notes that Supplementary Material .02(a) to ISE Rule 504 limits the Exchange's ability to list series unless another exchange lists a similar series at \$0.50 strike interval. In other words, if another exchange opens a \$40 strike in an Eligible Option Class, and ISE lists that \$40 strike pursuant to Supplementary Material .02(a), ISE would not therefore be permitted to open strikes of \$39.50 or \$40.50 in that class of option.

particularly when many of these platforms enjoy substantially smaller strike price differentiations (e.g., as low as \$.05).⁹

The Exchange notes that this proposed rule change has the support of several ISE market makers. This proposal was developed in consultations with one such market-making firm. The ISE Board of Directors, which includes several major market makers, also voted in favor of this proposal.

Following is an example of how existing strike intervals in the Eligible Option Classes negatively impact trading and hedging opportunities. If an investor needs to purchase a call option in CSCO (03/26/12 closing price \$20.84), the current one dollar strike interval would offer less opportunity and choice for an investor seeking to keep cash expenditures low. For example, an investor wishing to buy an in-the-money call option for less than a \$2.50 investment per call purchase has only two strike prices that meet his criteria from which to choose: the 19 strike and the 20 strike. Such call options with five days until expiration might offer “ask prices” (option premiums) of \$1.75 and \$.75. However, if CSCO had \$0.50 strike prices as proposed, the same investor would have a selection of March 18.50, 19.00, 19.50, 20.00, and the 20.50 strike call options that may have options premiums from approximately \$2.25 down to approximately \$.25. This expanded range of strikes, and commensurate option premiums, offers far more choice and a considerably lower cost of entry to the investor, thereby garnering the investor more than a 66% options premium savings. Lower intervals offer more trading and hedging opportunity at lower cost. Clearly, more efficient pricing is advantageous to

⁹ As an example, per the CME Group website, <http://www.cmegroup.com/trading/metals/precious/ProductOverride/SO-silver-options.html>, strike prices for options on futures may be at an interval of \$.05 and \$.25 per specified parameters.

all market participants, from retail to institutional investors. The changes proposed by the Exchange should allow execution of more trading and hedging strategies on the Exchange. The Exchange notes that in conformance with ISE Rules, the Exchange shall not list \$0.50 strike price intervals on non-STOS options within five (5) days of expiration. For example, if a non-STO in an options class is set to expire on Friday, March 16, the Exchange could begin to trade \$0.50 strike price intervals surrounding that non-STO on Monday, March 12, but no later.

The Exchange notes that liquidity levels at each individual option series could decrease as a result of listing short term options series at more granular strike increments. ISE, however, does not expect a significant change in liquidity, nor does the Exchange expect overall liquidity in these products to decline. Moreover, this proposal will result in more targeted liquidity being available for industry participants, allowing liquidity providers to better concentrate their efforts in parts of the markets where liquidity is most needed.

With regard to the impact of this proposal on system capacity, the Exchange has analyzed its capacity and represents that it and the Options Price Reporting Authority have the necessary systems capacity to handle the potential additional traffic associated with trading Eligible Option Classes in narrower strike price intervals. Further, the Exchange notes that this proposal, if approved, would not increase the number of listed short-term series.

The Exchange also proposes that during the expiration week of an option class that is selected for the STOS Program, the strike price intervals for the related non-STOS option shall be the same as the strike price intervals for the STOS option. The Exchange

proposes to make this change to ensure conformity between STOS options and non-STOS options that are in the same options class (e.g., weekly and monthly SPY options). The Exchange believes that not having such a conforming change would be counter-productive and not beneficial for trading and hedging purposes.¹⁰

The Exchange believes that listing \$0.50 strike prices in a handful of option classes has provided investors with greater trading opportunities and the ability to more closely tailor their investment and risk management strategies and decisions. However, due to limitations imposed by ISE's rules, the Exchange has had to reject trading requests to list more option classes in narrower strike prices. The Exchange believes a gradual expansion of strike price intervals, as proposed herein, and limiting it to the Eligible Option Classes will provide investors with better and more choices for investment, trading and risk management purposes.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Securities Exchange Act of 1934¹¹ (the "Act") in general, and furthers the objectives of Section 6(b)(5) of the Act¹² in particular, in that it is designed to promote just and equitable principles of trade, 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. The Exchange believes that providing strike

¹⁰ Moreover, the Exchange notes that STOS options are not listed and traded during the expiration week of the related non-STOS options. During this week, the non-STOS options are materially and financially equivalent to the STOS options. The proposed change would allow traders and hedgers to have the noted benefits of the STOS Program during each week in a month.

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

prices of \$0.50 in the Eligible Option Classes is reasonable because doing so will result in a continuing benefit to investors by giving them more flexibility to closely tailor their investment and hedging decisions in a greater number of securities. The Exchange also believes it is reasonable to provide the same strike price intervals for option classes that are in the STOS Program and for the related non-STOS option during expiration week because doing so will ensure conformity between STOS options and non-STOS options that are in the same options class. While the proposed rule change will generate additional quote traffic, the Exchange does not believe that this increased traffic will become unmanageable since the proposal remains limited to a fixed number of classes.

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 publication date of this notice or within such longer period (1) as the Commission may designate up to 45 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (2) 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-2012-33 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-2012-33. 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. The text of the proposed rule change is available on the Commission's website at <http://www.sec.gov>. 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-2012-33 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.¹³

Kevin M. O'Neill
Deputy Secretary

¹³ 17 CFR 200.30-3(a)(12).