

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68000; File No. SR-ISE-2012-81)

October 5, 2012

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Adopt a Pilot Program to Eliminate Position and Exercise Limits in SPY Options

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 September 27, 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 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 eliminate position and exercise limits for physically-settled options on the SPDR S&P ETF Trust (“SPY”) pursuant to a pilot program.

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

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

ISE proposes to amend Supplementary Material .01 to ISE Rule 412 and Supplementary Material .01 of ISE Rule 414 to eliminate position and exercise limits, respectively, for physically-settled SPY options pursuant to a pilot program. This filing is based on a filing previously submitted by NYSE MKT LLC (f/k/a NYSE Amex, LLC (“NYSE Amex”)), which the Commission recently approved.³

The Exchange began trading SPY options on January 10, 2005. That year, the position limit for these options was increased from 75,000 contracts to 300,000 contracts on the same side of the market.⁴ In July 2011, the position limit for these options was again increased from 300,000 contracts to the current limit of 900,000 contracts on the same side of the market.⁵

The underlying SPY generally tracks the performance of the S&P 500 Index and the Exchange states that the SPY and SPY options have deep, liquid markets that reduce concerns regarding manipulation and disruption in the underlying markets. In support of this proposed rule change, the Exchange has collected the following trading statistics for SPY and SPY options: (1) the average daily volume (“ADV”) to date (as of August 24, 2012) for SPY is 148 million shares; (2) the ADV to date in 2012 for SPY options is 2.6 million; (3) the total shares

³ See Securities Exchange Act Release No. 67672 (August 15, 2012), 77 FR 50750 (August 22, 2012) (SR-NYSEAmex-2012-29).

⁴ See Securities Exchange Act Release No. 51042 (January 14, 2005), 70 FR 3412 (January 24, 2005) (SR-ISE-2005-05).

⁵ See Securities Exchange Act Release No. 64760 (June 28, 2011), 76 FR 39143 (July 5, 2011) (SR-ISE-2011-34).

outstanding for SPY are 750.3 million; and (4) the fund market cap for SPY is \$106 billion. The Exchange represents further that there is tremendous liquidity in the securities that make up the S&P 500 Index. For example, the ADV of the component securities in the S&P 500 Index for the 6-month period of February 28, 2012 through August 28, 2012 was 635,583,189.

Under the Exchange's proposal, the options reporting requirement for SPY options would continue unabated. Thus, the Exchange would still require that each Member that maintains a position in SPY options on the same side of the market, for its own account or for the account of a customer, report certain information to the Exchange. This information would include, but would not be limited to, the option position, whether such position is hedged and, if so, a description of the hedge, and the collateral used to carry the position, if applicable. Exchange market makers would continue to be exempt from this reporting requirement, as market maker information can be accessed through the Exchange's market surveillance systems. In addition, the general reporting requirement for customer accounts that maintain an aggregate position of 200 or more option contracts would remain at this level for SPY options.⁶

In addition, ISE Rule 4.15 (b) [sic] provides:

Electronic Access Members that maintain an end of day position in excess of 10,000 non-FLEX equity options contracts on the same side of the market on behalf of its own account or for the account of a customer, shall report whether such position is hedged and provide documentation as to how such position is hedged. This report is required at the time the subject account exceeds the 10,000 contract threshold and thereafter, for

⁶ See ISE Rule 415(a).

customer accounts, when the position increases by 2,500 contracts and for proprietary accounts when the position increases by 5,000 contracts.

As the anniversary of listed options trading approaches its fortieth year, the Exchange believes that the existing surveillance procedures and reporting requirements at ISE, other options exchanges, and at the several clearing firms are capable of properly identifying unusual and/or illegal trading activity. In addition, routine oversight inspections of the Exchange's regulatory programs by the Commission have not uncovered any material inconsistencies or shortcomings in the manner in which the Exchange's market surveillance is conducted. These procedures utilize daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both options and underlying stocks.⁷

Furthermore, large stock holdings must be disclosed to the Commission by way of Schedules 13D or 13G.⁸ Options positions are part of any reportable positions and, thus, cannot be legally hidden. Moreover, the Exchange's requirement that Members file reports with the Exchange for any customer who held aggregate large long or short positions of any single class for the previous day will continue to serve as an important part of the Exchange's surveillance efforts.

The Exchange believes that the current financial requirements imposed by the Exchange and by the Commission adequately address concerns that a Member or its customer may try to maintain an inordinately large un-hedged position in an option, particularly on SPY. Current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a Member must

⁷ These procedures have been effective for the surveillance of SPY options trading and will continue to be employed.

⁸ 17 CFR 240.13d-1.

maintain for a large position held by itself or by its customer. In addition, the Commission's net capital rule, Rule 15c3-1⁹ under the Securities Exchange Act of 1934 (the "Act"),¹⁰ imposes a capital charge on members to the extent of any margin deficiency resulting from the higher margin requirement.

Pilot Program

The Exchange proposes that this rule change be adopted pursuant to a pilot program, set to expire December 5, 2013.¹¹ The Exchange will perform an analysis of the initial pilot program to eliminate position limits in SPY after the first twelve (12) months of the pilot program (the "Pilot Report"). The Pilot Report will be submitted within thirty (30) days of the end of such twelve (12) month time period. The Pilot Report will detail the size and different types of strategies employed with respect to positions established as a result of the elimination of position limits in SPY. In addition, the report will note whether any problems resulted due to the no limit approach and any other information that may be useful in evaluating the effectiveness of the pilot program. The Pilot Report will compare the impact of the pilot program, if any, on the volumes of SPY options and the volatility in the price of the underlying SPY shares, particularly at expiration. In preparing the report the Exchange will utilize various data elements such as volume and open interest. In addition the Exchange will make available to Commission staff data elements relating to the effectiveness of the pilot program.

Conditional on the findings in the Pilot Report, ISE will file with the Commission a proposal to either extend the pilot program, adopt the pilot program on a permanent basis, or

⁹ 17 CFR 240.15c3-1.

¹⁰ 15 U.S.C. 78s(b)(1).

¹¹ The Exchange will notify ISE Members of the establishment of the pilot program and the running dates of the pilot program via regulatory circular.

terminate the pilot program. If the pilot program is not extended or adopted on a permanent basis by December 5, 2013, the position limits for SPY would revert to limits in effect at the commencement of the pilot program.

The Exchange believes that the elimination of position and exercise limits on SPY options on a pilot basis is required for competitive purposes as well as for purposes of consistency and uniformity among the competing options exchanges. This supports the Exchange's current proposal to eliminate the position and exercise limits applicable to physically-settled SPY options on a pilot basis.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the Securities Exchange Act of 1934¹² (the "Act") in general, and furthers the objectives of Section 6(b)(5) of the Act¹³ 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.

Specifically, the proposed rule change will benefit large market makers (which generally have the greatest potential and actual liability [sic] to provide liquidity and depth I [sic] the product), as well as retail traders, investors, and public customers, by providing them with a more effective trading and hedging vehicle. In addition, the Exchange believes that the structure of SPY options and the considerable liquidity of the market for SPY options diminish the opportunity to manipulate this product and disrupt the underlying market that a lower position

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

limit may protect against. The Exchange also believes that the proposed rule change will benefit a greater number of market participants who are ISE Members and members of other exchanges. This is because SPY is a multiply listed options class and currently there is not a uniform and consistent position and exercise limits regime across all of the exchanges that list SPY options. The proposed filing will benefit market participants because it will ensure consistency and uniformity among the competing options exchanges as to the position and exercise limits for a multiply listed options class.

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

ISE does not believe that this proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. In this regard and as indicated above, the Exchange notes that the rule change is being proposed as a competitive response to a NYSE Amex filing. ISE believes this proposed rule change is necessary to permit fair competition among the options exchanges and to establish uniform positions for a multiply listed options class.

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 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 prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, the proposed rule change has become effective pursuant to Section

19(b)(3)(A) of the Act¹⁴ and Rule 19b-4(f)(6) thereunder.¹⁵

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act¹⁶ normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)¹⁷ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay, noting that doing so will ensure fair competition among options exchanges and immediately benefit market participants who are ISE members and members of other exchanges by ensuring consistency and uniformity across options exchanges with respect to the multiply listed SPY options class. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.¹⁸ Therefore, the Commission hereby waives the 30-day operative delay and designates the proposal operative as of October 5, 2012.

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.

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 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.

¹⁶ 17 CFR 240.19b-4(f)(6).

¹⁷ 17 CFR 240.19b-4(f)(6).

¹⁸ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-2012-81 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-2012-81. 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-2012-81 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.¹⁹

Kevin M. O'Neill
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).