

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64719; File No. SR-ISE-2011-33)

June 22, 2011

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change Relating to Appointments to Competitive Market Makers

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 June 10, 2011, 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 revise the manner in which Competitive Market Makers are appointed to options classes. 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 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.

¹ 15 U.S.C. 78s(b)(1).

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The ISE's membership is divided into three categories, Primary Market Makers ("PMMs"), Competitive Market Makers ("CMMs") and Electronic Access Members. There are 10 PMM trading rights and 160 CMM trading rights (collectively "market maker rights"). In order to access the Exchange as a market maker, a member must own or lease one or more market maker rights. EAMs are not required to purchase a membership right in order to access the Exchange. Under the current structure, options traded on the Exchange are divided into 10 groups, with one of the 10 PMM trading right and 16 of the 160 CMM trading rights appointed to each group. Thus, each PMM and CMM trading right is associated with a specific group of options. This structure has been in place since ISE began operations in 2000. The purpose of this proposed rule change is to change the manner in which the Exchange appoints options classes with respect to CMM trading rights.

The Exchange proposes to change the structure of CMM appointments to give market makers more flexibility to choose the options classes to which they are appointed. Under the current structure that associates each membership with a particular group of options, a member generally must own or lease multiple CMM trading rights in order to gain access to the options classes in which it seeks to make markets. Moreover, the structure requires market makers to provide continuous quotations in a minimum number of options classed in each group, which results in some market makers entering in some options classes continuous quotations that are away from the national best bid and offer solely to satisfy the minimum requirement. While such quotations do not add to the quality of the ISE's market or the national market system, they place

² 17 CFR 240.19b-4.

a burden on the Exchange and its members with respect to the need to maintain additional systems capacity to handle the quotation traffic.

To address the issues created by the current CMM structure, the Exchange proposes to allow CMMs to seek appointment in the options classes listed on the Exchange across the groups of options assigned to particular PMMs. Under the proposal, the Exchange will assign points to each options class equal to its percentage of overall industry volume (not including exclusively-traded index options), rounded down to the nearest tenth of a percentage. A CMM will be able to seek appointments to options classes that total: (i) 20 points for the first CMM trading right it owns or leases; and (ii) 10 points for the second and each subsequent CMM trading right it owns or leases.³ CMMs will be able to change their appointments at any time upon advance notification to the Exchange.⁴ This structure is similar to the way in which the Chicago Board Options Exchange allows its market makers to choose options to which they are appointed.⁵

The Exchange believes that this proposal strikes an appropriate balance between the Exchange's goal of attracting additional market makers to the Exchange and the interests of the

³ Under the proposal, CMMs can select the options classes to which they seek appointment, but the Exchange retains the authority to make such appointments and to remove appointments from CMMs based on their performance. In this respect, under the current rule, the Board or a committee designated by the Board makes appointments to market makers. In consideration of the new process for making CMM appointments, the Exchange is proposing to allow the Exchange to make appointments to market makers. Under the proposal, either the Exchange or a committee designated by the Board will be permitted to make appointments. The Board itself has never made market makers appointments, and the Exchange does not believe such determinations require Board-level consideration.

⁴ The Exchange will notify CMMs of the procedure for requesting changes to their appointments, including the length of advance notification required. The Exchange will establish the shortest advance notification period that is operationally feasible, such as a specific time on the day prior to the intended effectiveness of a change in a CMM's appointments, or by a specified time prior to the opening on the same trading day.

⁵ CBOE Rule 8.3 (Appointment of Market Makers).

current CMMs on the Exchange. Under the existing structure, a member is required to own and/or lease 10 CMM trading rights (one in each of the 10 options groups) in order to have the ability to make markets in all of the options classes traded on the Exchange. Moreover, because the number of options classes contained in each group varies, CMM trading rights currently represent 10 different levels of participation. Under the proposal, the level of access gained by owning or leasing a CMM trading right will be standardized. Finally, the proposal will make additional memberships available, which will provide greater opportunity for more market makers to join the Exchange.

Specifically, by assigning 20 points to the first CMM trading right owned or leased by a member and 10 points to each subsequent CMM trading right owned or leased by the same member, only 9 CMM trading rights will be required to cover the entire ISE market.

Accordingly, members that currently own or lease 10 CMM trading rights will be able to sell or discontinue leasing one of their CMM trading rights. Similarly, other market makers on the ISE also will be able to reduce the number of CMM trading rights they need to gain access to the options classes in which they want to make markets. Thus, the proposal will reduce the cost of market making on the ISE and increase the supply of available CMM trading rights, which will provide the opportunity for more market makers to join the ISE. Moreover, assigning the first CMM trading right that is owned or leased by a market maker 20 points and subsequent CMM trading rights 10 points takes into consideration that the CMM trading rights currently are assigned to groups with a varying number of options classes. This structure makes it less likely that current market makers with CMM trading rights primarily in the larger groups will be negatively impacted by the proposed change.⁶

⁶ The Exchange will provide members with a transition period of 30 to 60 days following approval of the proposed rule change. During the transition period, the Exchange will

The Exchange also proposes to adjust its CMM quotation requirements to reflect the proposed elimination of specified groups of options associated with CMM trading rights. Specifically, under the current structure, CMMs are required to participate in the opening and provide continuous quotations in a minimum number of options classes in each of their assigned groups. Since CMMs will have the flexibility to choose the options classes to which they are appointed rather than being appointed to a pre-determined group of options, the Exchange proposes to modify this requirement to limit the number of appointed options classes in which a CMM can initiate intraday quoting to the number of options classes in which it participates in the opening rotation.

Under the current rules, a CMM is required to participate in the opening in 60% of the options classes in its appointed group of options or 40 options classes, whichever is lesser. If, for example, a CMM is appointed to a group with 100 options classes, then it must participate in the opening for 40 options classes and may initiate intra-day quoting in 60 options classes. Under the proposed structure, a CMM appointed to 100 options classes that participates in the opening in 40 options classes may only initiate intra-day quoting in 40 additional classes. There is no minimum number of options classes in which a CMM must quote because under the new structure, CMMs presumably will not seek appointment to options classes unless they want to quote them. Thus, the Exchange believes it is reasonable to adopt a structure that is more restrictive with respect to entering quotes after the opening. In addition, this requirement currently is in place for options classes traded in the Exchange's Second Market,⁷ and the

work with existing market makers to restructure their appointments within the new point-based structure.

⁷ ISE Rule 904(a).

Exchange believes it effectively encourages market makers to provide added liquidity during the opening.

Additionally, under the proposal the Exchange will retain the current requirement that once a CMM enters a quotation in an appointed options class, it must maintain continuous quotations for that series and at least 60% of the series of the options class until the close of trading that day.⁸ If a CMM receives Preferred Orders in an options class, it will continue to be required to maintain continuous quotations in at least 90% of the series in that class. Finally, the Exchange will continue to have the ability under its rules to call upon a CMM to submit quotations in one or more series of an options class to which the CMM is appointed.⁹

Finally, the Exchange proposes to terminate its current CMM inactivity fee. That fee currently imposes a charge of \$25,000 a month for CMM trading rights that are not active. The purpose of the fee is to help recoup a portion of the income that the Exchange loses when market makers do not operate their trading rights and generate transaction-based revenue. Under the proposed CMM trading rights structure, the Exchange does not believe that the inactivity fee is appropriate or necessary, as CMMs will now be able to manage the number of options classes to which they are appointed.¹⁰ Moreover, we believe that there will be increased demand for CMM trading rights, and that owners of such rights will have a financial incentive to sell or lease

⁸ CMMs will continue to be subject to the quotation requirements contained in Rule 803 and 804.

⁹ The proposal also amends Rule 805 to correct a cross-reference to Rule 804, and amends rule 810 to replace a reference to appointment to groups with a reference to appointed options.

¹⁰ For example, under the current structure, a CMM that owns or leases three CMM trading rights is obligated to continuously quote a minimum of 120 options classes. Under the new structure, a CMM with three trading rights could seek appointment for only three options classes (one for each trading right), thus making the inactivity fee ineffective.

any unused trading rights. If this does not turn out to be the case, the Exchange will consider reinstating some form of inactivity fee that is appropriate for the new structure.

2. Basis

The basis under the Act for this proposed rule change is found in Section 6(b)(5),¹¹ in that the proposed change 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. In particular, the proposal will provide more open access to the Exchange for market makers. It will also permit broker-dealer members of the ISE to use their CMM trading rights more efficiently, lowering their costs of providing liquidity on the Exchange. At the same time, because a PMM will continue to be appointed to each options class, there will continue to be continuous, two-sided quotations in all options listed on the Exchange.¹² As further required under Section 6(b)(5) of the Exchange Act, the proposal will not result in unfair discrimination between customers, issues, brokers or dealers. Indeed, any and all potential market makers will be able to purchase or lease newly-available CMM trading rights.

Pursuant to Section 6(b)(8) of the Exchange Act,¹³ the proposed rule change is designed to foster competition, both with respect to exchange competition and broker-dealer competition, as it will encourage additional market maker participation. The additional market making interest that this will attract to the ISE will make the ISE more competitive with other exchanges that have a market making structure which is less limited as the ISE's current structure. As to

¹¹ 15 U.S.C. 78f(b)(5).

¹² Pursuant to Rule 804(a)(2), PMMs have the obligation to provide continuous quotations in all of the series of all of the options to which they are appointed.

¹³ 15 U.S.C. 78f(b)(8).

broker-dealers, this proposal will permit more broker-dealers to join the ISE and disseminate competitive quotations, which will enhance competition among market makers.

Finally, the proposal to eliminate the CMM inactivity furthers Section 6(b)(4) of the Exchange Act¹⁴ in that it is an equitable allocation of reasonable fees and other charges among Exchange members and other persons using its facilities. The Exchange believes that eliminating the inactivity will potentially lower costs for members providing liquidity on the Exchange. Furthermore, it will apply equally to all CMMs and thus is not discriminatory.

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.

¹⁴ 15 U.S.C. 78f(b)(4).

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 the 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-2011-33 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-2011-33. 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, 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-ISE-2011-33 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Cathy H. Ahn
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).