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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74465; File No. SR-ISE-2014-24)

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Modify ISE's Opening Process

March 10, 2015

I. Introduction

On November 19, 2014, the International Securities Exchange, LLC (the "Exchange" or the "ISE") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to modify the opening process of the Exchange. The proposed rule change was published for comment in the Federal Register on December 10, 2014.³ On January 23, 2015, the Commission extended the time period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change, to March 10, 2015.⁴ The Commission received no comment letters on the proposed rule change. This order institutes proceedings under Section 19(b)(2)(B) of the Act⁵ to determine whether to approve or disapprove the proposed rule change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 73736 (December 4, 2014), 79 FR 73354 ("Notice").

⁴ See Securities Exchange Act Release No. 74126 (January 23, 2015), 80 FR 4953 (January 29, 2015).

⁵ 15 U.S.C. 78s(b)(2)(B).

II. Description of the Proposal

The Exchange proposes to (1) clarify and codify existing functionality within the trading system regarding the procedures for initiation of the opening process, and (2) modify the manner in which the Exchange's trading system opens trading at the beginning of the day and after trading halts.

According to the Exchange, the proposed rule change would codify certain existing functionality within the trading system that was not previously described in the Exchange's rule and would provide new procedures for initiation of the opening rotation at the Exchange's opening and reopening after a trading halt. A more detailed description of the initiation procedure is available in the Notice.⁶

The Exchange also proposes to amend its opening rotation process. The Exchange believes that there are issues with its current opening process. Namely, because its opening process does not provide away market price protection, the Exchange believes that order flow providers are sending fewer pre-open orders to ISE. In addition, the Exchange states that "the opening of options series can be delayed by imbalances that prevent ISE from determining an opening price in a timely manner" and that "such delays exacerbate the problem of not providing price protection at the opening."⁷

To address its concerns, ISE proposes an iterative opening process. As described in the Notice, in the first iteration, the trading system will attempt to derive the first opening price to be at or better than the ISE Market Maker quotes and away best bid or offer ("ABBO") prices.

⁶ See Notice, supra note 3 at 73355.

⁷ See Notice, supra note 3 at 73356.

When there is executable interest, the trading system will first calculate a range of prices within which to open the options series (“Boundary Prices”). As is the case today, the trading system will use quotes provided by the Primary Market Maker (“PMM”) for the series in question to set the first Boundary Prices. If the PMM is not present on either side of the market, then the best quotes from the Competitive Market Makers (“CMMs”) will be used on the corresponding side. If there are no PMM or CMM quotes on the bid side, the lowest minimum trading increment for the option class will be used on the bid side. If there are no PMM or CMM quotes on the offer side, the options class will not open because in the absence of an offer there is no limit as to the price at which an opening trade can occur. If the options class is open on another exchange, the Boundary Prices will be determined to be the higher of the ISE Market Maker’s bid in that options class and the national best bid, and the lower of the ISE Market Maker’s offer in that options class and the national best offer.

Once the trading system has determined the Boundary Prices, as appropriate, it then will determine the price at which the maximum number of contracts can trade at or within the appropriate Boundary Prices (the “execution price”).⁸ Once the trading system determines the execution price, orders and quotes will be processed as follows—market orders will be given priority before limit orders and quotes, and limit orders and quotes will be given priority by price. For limit orders and quotes with the same price, priority will be accorded first to Priority

⁸ See Notice, supra note 3, at 73356, for an example showing the calculation of the execution price following the first iteration.

Customer Orders⁹ over Professional Orders¹⁰ and quotes. Priority Customer Orders with the same limit price will be executed in random¹¹ while Professional Orders and quotes with the same limit price will be executed pro-rata based on size. If the Boundary Prices are calculated using the national best bid or offer (“NBBO”), any remaining Public Customer Orders¹² after this iteration that would lock or cross a bid or offer from another exchange will be processed in accordance with Supplementary Material .02 to ISE Rule 1901.¹³ Any remaining Non-Customer

⁹ Pursuant to ISE Rules 100(a)(37A) and 100(a)(37B), a Priority Customer Order is an order for the account of a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).

¹⁰ Pursuant to ISE Rule 100(a)(37C), a Professional Order is an order that is for the account of a person or entity that is not a Priority Customer.

¹¹ Priority Customer orders with the same limit price in the regular order book are currently executed in time priority during the opening. The Exchange believes executing these orders on a random basis is a fairer approach because the current time priority is dependent on when such orders are communicated to the Exchange by a Priority Customer’s broker before the market, not the time the Priority Customer expressed interest in doing the trade. Executing these orders in random will provide Priority Customer orders an equal opportunity to participate at the open.

¹² Pursuant to ISE Rules 100(a)(38) and 100(a)(39), a Public Customer means a person or entity that is not a broker or dealer in securities and a Public Customer Order means an order for the account of a Public Customer.

¹³ Under the Options Order Protection and Locked/Crossed Market Plan (“Options Linkage Plan”), the Exchange cannot execute orders at a price that is inferior to the NBBO, nor can the Exchange place an order on its book that would cause the ISE best bid or offer to lock or cross another exchange’s quote. In compliance with this requirement, Non-Customer Orders and Public Customer Orders are exposed to all ISE Members for up to one second to give them an opportunity to execute orders at the NBBO price or better before orders are rejected (in the case of Non-Customer Orders) or routed out to other exchanges (in the case of Public Customer Orders). See Supplementary Material .02 to Rule 1901.

Orders¹⁴ that would lock or cross a bid or offer from another exchange may trade outside the Boundary Prices by up to two trading increments as further described under the third iteration below.

If after the first iteration there remain unexecuted orders and quotes that lock or cross each other, the trading system will initiate a second iteration.¹⁵ In the second iteration, the trading system will use either the ISE Market Maker quotes or the ABBO prices,¹⁶ whichever was not used in the first iteration, to establish the Boundary Prices. For example, if the ISE Market Maker quotes were used in the first iteration, the second iteration will use ABBO prices and vice versa. If there were no ABBO prices for consideration for the first iteration, then this second iteration will not occur and the trading system will initiate the third iteration as described below.

In the second iteration, the trading system will again determine the execution price at which the maximum number of contracts can trade at or within the widened Boundary Prices. Once the trading system determines the second execution price, orders and quotes will be processed as follows—market orders will be given priority before limit orders and quotes, and limit orders and quotes will be given priority by price. For limit orders and quotes with the same price, priority will be accorded first to Priority Customer Orders over Professional Orders and quotes. Priority Customer Orders with the same limit price will be executed in random order while Professional Orders and quotes with the same limit price will be executed pro-rata based

¹⁴ Pursuant to ISE Rules 100(a)(27) and (28), a Non-Customer means a person or entity that is a broker or dealer in securities and a Non-Customer Order means an order for the account of a Non-Customer.

¹⁵ See Notice, supra note 3, at 73357, for an example showing the calculation of the execution price following the second iteration.

¹⁶ The ABBO prices considered in the first iteration are also used during the second iteration.

on size. If the Boundary Prices in the second iteration are calculated using the NBBO, any remaining Public Customer Orders after this iteration that would lock or cross a bid or offer from another exchange will be processed in accordance with Supplementary Material .02 to ISE Rule 1901. Any remaining Non-Customer Orders that would lock or cross a bid or offer from another exchange may trade outside the Boundary Prices by up to two trading increments as further described under the third iteration below.

If after the second iteration there remain unexecuted orders and quotes that lock or cross each other, the trading system will initiate a third iteration.¹⁷ In the third iteration, the prior Boundary Prices, i.e., the prices used in the second iteration, and in the case where the second iteration does not occur, the prices used in the first iteration, will be widened by two trading increments. The trading system will then determine the price at which the maximum number of contracts could trade at or within the widened Boundary Prices. Once the trading system determines the third execution price, orders and quotes will be processed as follows—market orders will be given priority before limit orders and quotes, and limit orders and quotes will be given priority by price. For limit orders and quotes with the same price, priority will be accorded first to Priority Customer Orders over Professional Orders and quotes. Priority Customer Orders with the same limit price will be executed in random order while Professional Orders and quotes with the same limit price will be executed pro-rata based on size. Thereafter, any unexecuted Priority Customer Orders that lock or cross the Boundary Prices will be handled by the PMM¹⁸

¹⁷ See Notice, supra note 3, at 73357, for an example showing the calculation of the execution price following the third iteration.

¹⁸ The PMM has the obligation under existing Exchange rules to engage in dealings for its own account when, among other things, there is a temporary disparity between the supply of and demand for a particular options contract, and to act with due diligence in handling orders. See ISE Rule 803(c).

and any unexecuted Professional Orders and Non-Customer Orders that lock or cross the Boundary Prices will be canceled.

If after the third iteration there remain unexecuted orders and quotes that lock or cross each other, the trading system will initiate a fourth and final iteration.¹⁹ In the fourth iteration, the trading system will not calculate new Boundary Prices. The trading system will simply trade any remaining interest. Thereafter, the trading system will open the options series by disseminating the Exchange's best bid and offer derived from the remaining orders and quotes.

III. Proceedings to Determine Whether to Approve or Disapprove SR-ISE-2014-24 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act²⁰ to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change.

The Exchange believes that “each iteration of the proposed iterative process complies with Section 5(a) of the [Options] Linkage Plan, or qualifies as an exception under Section

¹⁹ See Notice, supra note 3, at 73357-8, for an example showing the calculation of the execution price following the fourth and final iteration.

²⁰ 15 U.S.C. 78s(b)(2)(B). Id. Section 19(b)(2) of the Exchange Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. See id. The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. See id.

5(b)(ii) of the [Options] Linkage Plan.”²¹ Section 5(a) – Order Protection – of the Options Linkage Plan requires that each participant exchange establish written policies and procedures that are reasonably designed to prevent trade-throughs and to conduct surveillance to ascertain the effectiveness of such policies and procedures.²² Section 5(b) provides a number of exceptions to the order protection requirements.²³ Section 5(b)(ii), in particular, provides an exception for a “transaction traded through a Protected Quotation being disseminated by an Eligible Exchange during a trading rotation.”²⁴

In the Commission’s Order approving the Options Linkage Plan,²⁵ the Commission stated that the Section 5(b)(ii) exception from trade-throughs was carried over from the previous linkage plan and is similar to an exception available for NMS stocks under Regulation NMS.²⁶ The Commission further noted that the “trading rotation” in the Options Linkage Plan is “effectively a single price auction to price the option.”²⁷

The Commission believes that ISE’s proposal raises interpretive issues that warrant further public comment and Commission consideration. Namely, the Commission believes that proceedings are appropriate to consider whether the Exchange’s proposed opening process, which would undertake potentially four separate iterations, each with its own execution price, is consistent with the Options Linkage Plan and with Section 6 of the Act, particularly Section

²¹ See Notice, supra note 3, at 73358.

²² Section 5(a) of the Options Linkage Plan.

²³ Section 5(b) of the Options Linkage Plan.

²⁴ Section 5(b)(ii) of the Options Linkage Plan.

²⁵ See Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (“Options Linkage Plan Approval Order”).

²⁶ See Options Linkage Plan Approval Order, id. at 39366.

²⁷ Id.

6(b)(5),²⁸ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposal is inconsistent with Section 6(b)(5)²⁹ or any other provision of the Act, or the rules and regulation thereunder.

Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.³⁰

In addition to any other facets of the proposal on which persons may seek to comment, the Commission is soliciting the views of interested persons regarding provisions of the proposed rule change concerning compliance with Section 5(a) of the Options Linkage Plan or qualification as an exception under Section 5(b)(ii) of the Options Linkage Plan.

²⁸ 15 U.S.C. 78f(b)(5).

²⁹ 15 U.S.C. 78f(b)(5).

³⁰ Section 19(b)(2) of the Act, as amended by the Securities Act Amendments of 1975, Pub. L. 94-29 (June 4, 1975), grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

Interested persons are invited to submit written data, views, and arguments regarding whether the proposal should be approved or disapproved by [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [insert date 35 days from publication in the Federal Register]. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the statements of the Exchange contained in the Notice,³¹ including the statements made with respect to compliance with the Options Linkage Plan, and any other issues raised by the proposed rule change.

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-2014-24 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE-2014-24. 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

³¹ See Notice, supra note 3.

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-2014-24 and should be submitted by [insert date 21 days from the date of publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³²

Brent J. Fields
Secretary
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³² 17 CFR 200.30-3(a)(57).