SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-62523; File No. SR-ISE-2010-73)

July 16, 2010

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change Relating To Modified Rules For Qualified Contingent Cross Orders

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 July 14, 2010, the International Securities Exchange, LLC ("Exchange" or "ISE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III 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 is proposing modified Qualified Contingent Cross Orders.[3] The text of the proposed rule change is as follows, with deletions in [brackets] and additions in italics:

Rule 715. Types of Orders

(a) through (i) no change.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 The Exchange first proposed to adopt Qualified Contingent Cross Orders in SR-ISE-2009-35. Infra note 6. This proposal was approved by the Division of Trading and Markets ("Division") pursuant to delegated authority, infra note 7, but this approval was stayed by a petition seeking fully Commission review. Infra note 8. The Exchange is now submitting this new proposed rule change that modifies the initial proposal, along with a letter requesting that the Commission vacate the Division's approval of SR-ISE-2009-35 simultaneously with approval of this modified proposal. Letter from Michael J. Simon, Secretary and General Counsel, ISE, dated July 14, 2010. The rule text presented in this proposed rule change shows proposed changes to ISE's rules as if the Commission vacated the Division's approval of SR-ISE-2009-35.

(j) Qualified Contingent Cross Order. A Qualified Contingent Cross Order is comprised of an order to buy or sell at least 1000 contracts that is identified as being part of a qualified contingent trade, as that term is defined in Supplementary Material .01 below, coupled with a contra-side order to buy or sell an equal number of contracts.

(k) through (l) no change.

Supplementary Material to Rule 715

.01 A "qualified continent trade" is a transaction consisting of two or more component orders, executed as agent or principal, where:

(a) At least one component is an NMS Stock, as defined in Rule 600 of Regulation NMS under the Exchange Act;

(b) all components are effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent;

(c) the execution of one component is contingent upon the execution of all other components at or near the same time;

(d) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined by the time the contingent order is placed;

(e) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and

(f) the transaction is fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade.

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Rule 721. [Customer Cross] Crossing Orders

(a) Customer Cross Orders are automatically executed upon entry provided that the execution is at or between the best bid and offer on the Exchange and (i) is not at the same price as a Public Customer Order on the Exchange's limit order book and (ii) will not trade through the NBBO.

[(a)] (1) Customer Cross Orders will be automatically canceled if they cannot be executed.

[(b)] (2) Customer Cross Orders may only be entered in the regular trading increments applicable to the options class under Rule 710.

[(c)] (3) Supplemental Material .01 to Rule 717 applies to the entry and execution of Customer Cross Orders.

(b) Qualified Contingent Cross Orders are automatically executed upon entry provided that the execution (i) is not at the same price as a Priority Customer Order on the Exchange's limit order book and (ii) is at or between the NBBO.

(1) Qualified Contingent Cross Orders will be automatically canceled if they cannot be executed.

(2) Qualified Contingent Cross Orders may only be entered in the regular trading increments applicable to the options class under Rule 710.

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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 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

Purpose – The Exchange proposes to adopt modified rules related to Qualified Contingent Cross Orders ("QCC"). The Exchange first proposed the adoption of the QCC in conjunction with the effectiveness of the Order Protection and Locked/Crossed Market Plan ("Distributive Linkage Plan")[4] and the Exchange's rules to implement the distributive linkage ("Distributive Linkage Rules").[5] After a full notice and comment period,[6] the Commission's Division of Trading and Markets ("Division") approved the proposal on behalf of the Commission by delegated authority.[7] However, this approval was automatically stayed by a petition submitted by the Chicago Board Options Exchange, Incorporated ("CBOE") requesting review of the filing by the full Commission.[8]

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4 Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009).

5 Securities Exchange Act Release No. 60559 (August 21, 2009), 74 FR 44425 (August 28, 2009) (Approval Order for SR-ISE-2009-27). See email from Michael Simon, Secretary and General Counsel, ISE, dated July 15, 2010, to Jennifer Colihan, Special Counsel, and Arisa Tinaves, Special Counsel, Division of Trading and Markets, Commission.

6 Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009) (Notice for ISE-2009-35).

7 Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009) (Approval Order for ISE-2009-35).

8 Letter from Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated September 14, 2009.

The Exchange has submitted extensive support for the approval of the QCC by the Division and the Commission,[9] and believes that it has fully addressed all of the issues raised by the commenters and provided the basis needed for the Commission to affirm the Division's approval of QCC. Nevertheless, the Commission has not taken action on the petition, and as a result of the stay, the Exchange has been at an extreme competitive disadvantage since the adoption of the Distributive Linkage Rules nearly one year ago. While the Exchange continues to believe QCC as originally approved by the Division is consistent with the Exchange Act, the Exchange believes this modified proposal addresses the two primary concerns raised by commenters. Specifically, this modified QCC proposal does not permit a QCC to be executed at the same price as a priority customer order on the Exchange and increases the required minimum size from 500 to 1000 contracts.[10]

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9 The ISE submitted a letter that addressed comments received by the Commission prior to the approval of the proposal. Letter from Michael J. Simon, Secretary and General Counsel, ISE, dated August 20, 2009. The ISE also submitted two briefs in support of a motion to lift the automatic stay that was imposed by the petition for review. Brief in Support of International Securities Exchange, LLC's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by Chicago Board Options Exchange, Incorporated's Notice of Intention to petition for Review, September 11, 2009; and Reply Brief in Support of International Securities Exchange, LLC's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by Chicago Board Options Exchange, Incorporated's Notice of Intention to petition for Review, September 22, 2009. Since denial of the Exchange's motion to lift the automatic stay, the Exchange has submitted additional support for QCC. Letters from Michael J. Simon, Secretary and General Counsel, ISE, dated December 3, 2009, December 16, 2009, March 1, 2010 and April 7, 2010. We incorporate by reference these submissions into this file number SR-ISE-2010-73.

10 Under ISE Rule 100(37A), a priority customer is 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). Pursuant to ISE Rule 713, priority customer orders are executed before other trading interest at the same price. See email from Michael Simon, Secretary and General Counsel, ISE, dated July 15, 2010, to Jennifer Colihan, Special Counsel, and Arisa Tinaves, Special Counsel, Division of Trading and Markets, Commission.

Background

The Distributive Linkage Plan replaced the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Old Linkage Plan"), and the Exchange's Linkage Rules replaced the existing ISE rules implementing the Old Plan (the "Old Linkage Rules"). The Old Linkage Plan and the Old Linkage Rules provided a limited Trade-Through exemption for "Block Trades," defined to be trades of 500 or more contracts with a premium value of at least $150,000.[11] However, as with Regulation NMS, the Distributive Linkage Plan did not provide a Block Trade exemption. At the time that it adopted the Distributive Linkage Rules, the Exchange recognized that the loss of the Block Trade exemption would adversely affect the ability of ISE members to effect large trades that are tied to stock.[12] Thus, the Exchange proposed the QCC as a limited substitute for the Block Trade exemption, to be implemented contemporaneously with the Linkage Rules.[13]

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11 Old Plan Sections 2(3) and 8(c)(i)(C); Old ISE Rule 1902(d)(2). See email from Michael Simon, Secretary and General Counsel, ISE, dated July 15, 2010, to Jennifer Colihan, Special Counsel, and Arisa Tinaves, Special Counsel, Division of Trading and Markets, Commission.

12 Both the Old Plan and the Distributive Linkage Plan have a Trade-Through exemption for "Complex Trades," including options trades tied to stock. See Old Plan section 7(c)(iii)(G),and Plan section 5(b)(viii). However, and while not free from doubt, the common application of that exemption has been to apply it only to trades announced to exchange members as a single trade at a net price. As so interpreted, that exemption would cover only trades executed in the ISE's "Complex Order Mechanism." See ISE Rule 722.

13 The Exchange asserted that the Qualified Contingent Cross Order was necessary to facilitate the execution of large stock/options combination orders. While broker-dealers could execute these orders in various ways, such as on the ISE's complex order book, they often seek the flexibility to execute the various legs of such orders in different markets, and may seek to execute the options leg alone on the ISE. Under the Distributive Linkage Plan, and without a Block Trade exemption, the Exchange knew it would be extremely difficult for ISE members to effect the execution of the options leg on the ISE. This has proved to be true since the implementation of Distributive Linkage.

Discussion

While Regulation NMS does not provide a Block Trade exemption from Trade-Through liability, the Commission, by order, has provided Trade-Through relief for "Qualified Contingent Trades" ("QCTs").[14] The QCT Release provides an exemption from Trade-Through liability in the equity market for multi-component, fully-hedged trades where one order is contingent on the execution of one or more additional orders. Building on this concept, we propose that when an ISE member effects a QCT trade in a Regulation NMS Stock that the member be permitted to cross the options leg of the trade on the ISE immediately upon entry if the order is for at least 1000 contracts, is part of a QCT,[15] is executed at a price at least equal to the national best bid or offer ("NBBO"), and there are no priority customer orders on the Exchange's book at the same price.

The QCC addresses the dislocation resulting from elimination of the Block Trade exemption by permitting members to provide their customers a net price for the entire trade, and then allowing the members to execute the options leg of the trade on the ISE at a price at least

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14 Securities Exchange Act Release No. 57620 (April 4, 2008) (the "QCT Release"). That release superseded a release initially granting the Qualified Contingent Trade exemption. Securities Exchange Act Release No.54389 (August 31, 2006).

15 We propose to define a QCC trade substantively identical to the Commission's definition in the QCT release. A QCC trade must meet the following conditions: (i) at least one component must be an NMS Stock; (ii) all the components must be effected with a product price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent; (iii) the execution of one component must be contingent upon the execution of all other components at or near the same time; (iv) the specific relationship between the component orders (*e.g.*, the spread between the prices of the component orders) must be determined by the time the contingent order is placed; (v) the component orders must bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and (iv) the transaction must be fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade. Consistent with the QCT Release members must demonstrate that the transaction is fully hedged using reasonable risk-valuation methodologies. <u>See</u> QCT Release, <u>supra</u> note 14, at footnote 9.

equal to the NBBO while using the QCT exemption to effect the trade in the equities leg at a price necessary to achieve the net price. Under the proposal, ISE will not permit the options component of a stock-option order to trade through the national best bid and offer ("NBBO").[16] Because the equity component of a stock-option order can be executed at any price under the QCT exemption from Regulation NMS, the pricing of the options component can be flexible. Indeed, whether the options component is executed at or between the ISE BBO is not material because, in most cases, the stock trade can be executed at a price that achieves the desired net price.[17] However, there are times when the quotation spread for the option on the ISE would not permit an execution of the options component between the ISE BBO, particularly in options that trade in increments greater than $0.01. In those cases, ISE proposes to permit an execution of the options component at a price that matches the ISE BBO.[18] Moreover, under the modified

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16 While the QCC does not provide exposure for price improvement for the options leg of a stock-option order, the options leg must be executed at the NBBO or better. The Commission has previously approved crossing transactions with no opportunity for price improvement. See, e.g., ISE Rule 721(a); and CBOE Rule 6.74A, Interpretations and Policies .08.

17 For example, assume two parties negotiate a stock-option order to buy 100,000 shares and sell 1,000 calls with a net price of 24.38. Further assume that the NBBO for the option is $0.82 by $0.86, and that the NBBO for the stock is $25.20 by $25.21. The broker sends an order to the ISE to execute the options component at $0.85 and sends the equity component to an equities marketplace at $25.33. Note that in this example there is a range of prices at which the price of the components could be executed between the NBBO for the option, e.g., the options component could be executed at $0.83, $0.84 or $0.85, and the equity component could be executed respectively at $25.31, $25.32, or $25.33.

18 Continuing with the example from note 17 above, assume that the NBBO and ISE BBO for the option is $0.85 by $0.86. According to the CBOE's letter, the contingent trade should not be permitted because the spread in the option is at a minimum increment.

proposal, ISE will not permit the execution of a QCC at the same price as a priority customer order. In such a case, the QCC will be rejected.[19]

The ISE's proposal addresses the mechanics of executing the stock and options components of a net-price transaction in disparate markets with different execution rules, different trading increments and different intermarket trade-through provisions. On balance, we believe that providing members with the certainty that they could execute the options legs of the large complex orders for their customers, coupled with the flexibility members would have with respect to the price at which the equity legs are executed, would provide customers with the flexibility needed to achieve their investment objectives. Moreover, the modifications to the proposal to prevent the execution of a QCC if there is a priority customer on the book and to increase the minimum size of a QCC remove the appearance that such orders are trading-ahead of priority customer orders or that the QCC could be used to disadvantage retail customers, the two most significant issues raised by commenters on the initial proposal.[20]

Basis – The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5) that an exchange have rules that are 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest. In particular, the proposed changes to QCC will prevent executions from occurring when there is a priority customer order on the book at the same price and will assure that only large-size orders (i.e., of at least 1000 contracts) are eligible. The modified rules will facilitate the ability of ISE members to execute

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19 The Commission has previously approved the rejection of crossing transactions when there is a priority customer order on the book at the same price. See, e.g., ISE Rule 721(a); and CBOE Rule 6.74A, Interpretations and Policies .08.

20 See infra note 22.

large options orders that are tied to stock in an efficient manner, while also protecting the national market system against trade-throughs.

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

This proposed rule change does not impose any burden on competition. Rather, approval of QCC as modified by the proposed rule change, will address a significant existing burden on competition. In particular, it will permit fair competition between floor-based and electronic options exchanges for large-size stock-option orders.[21]

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.[22]

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date 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:

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21 ISE has submitted numerous letters detailing how the loss of the Block Exemption without the alternative QCC has made it virtually impossible for our all-electronic exchange to compete with the floor-based trading models for these large-size stock-option orders. Supra note 9.

22 The Commission received a number of comments with respect to SR-ISE-2009-35, supra note 6, which can be found at http://www.sec.gov/comments/sr-ise-2009-35/ise200935.shtml#order. The Commission also received comments with respect to the petition for full Commission review of SR-ISE-2009-35, supra note 6, which can be found at http://www.sec.gov/rules/other/2009/sr-ise-2009-35/ise200935_statements.shtml. ISE's responses to these comments, supra note 7, are included at these locations.

(a) by order approve 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 No. SR-ISE-2010-73 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-2010-73. 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 Commissions Internet Web site (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 on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available 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-2010-73 and should be submitted by [insert date 15 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[23]

Florence E. Harmon
Deputy Secretary

[23] 17 CFR 200.30-3(a)(12).