

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74004; File No. SR-ISE-2014-56)

January 6, 2015

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Regarding Complex Orders

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 December 23, 2014 the International Securities Exchange, LLC (the “Exchange” or the “ISE”) filed with the Securities and Exchange 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 ISE proposes to amend its rules to permit a greater number of complex orders to leg into the regular market. The text of the proposed rule change is available on the Exchange’s website (<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 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 permit a greater number of complex orders to leg into the regular market. The Exchange currently provides functionality that automatically removes a market maker's quotes in all series of an options class when certain parameter settings are triggered.³ The purpose of this functionality is to allow market makers to provide liquidity across hundreds of options series without being at risk of executing the full cumulative size of all such quotes before being given the opportunity to adjust their quotes. By checking the risk parameters following each execution in an options series, the risk parameters allow market makers to manage their risk. This is not the case, however, when a complex order legs into the regular market. Because the execution of each leg is contingent on the execution of the other legs, the execution of all the legs in the regular market is processed as a single transaction, not as a series of individual transactions. The legging-in of complex orders therefore presents a higher risk to market makers as compared to regular orders being entered in multiple series of an options class in the regular market as it can result in market makers exceeding their parameters by a greater number of contracts. Because this risk is directly proportional to the number of legs associated with a complex order, the Exchange amended Rule 722 to limit the legging functionality to complex orders with no more than either two or three legs, as determined by the Exchange on a class basis.⁴ The Legging Filing effectively limited certain legitimate complex

³ See ISE Rules 722 and 804.

⁴ See Securities Exchange Act Release No. 70132 (August 7, 2013), 78 FR 49311 (August 13, 2013) (SR-ISE-2013-38) (the "Legging Filing").

order strategies, such as a Box Spread⁵ or a Condor,⁶ from legging into the regular market.

These strategies are limited to trading with other complex orders in the complex order book.

Despite the limitation adopted in the Legging Filing, certain market participants continued to use atypical multi-leg strategies to trade with multiple quotes from a single market maker that caused single leg market makers to trade far more than their risk limits allowed. To minimize this risk, the Exchange recently amended its rules to prevent these atypical multi-leg strategies from legging into the regular market. These atypical multi-leg strategies are complex orders with two option legs where both legs are buying or both legs are selling and both legs are calls or both legs are puts, and complex orders with three options legs, where all legs are buying or all legs are selling regardless of whether the option is a call or a put (“Non-Standard Strategies”).⁷ Non-Standard Strategies are permitted to trade only in the complex order book and are prevented from legging into the regular market.⁸

⁵ The box spread, or long box, is a common strategy that involves buying a call spread together with the corresponding put spread with both spreads having the same strike prices and expiration dates. A box spread can be constructed by buying one in-the-money call, selling one out-of-the-money call, buying one in-the-money put and selling one out-of-the-money put. The long box is used when the spreads are underpriced in relation to their expiration values.

⁶ The condor option strategy is a limited risk, non-directional option trading strategy that is structured to earn a limited profit when the underlying security is perceived to have little volatility. To establish this position, a options trader sells an in-the-money call, buys an in-the-money call (lower strike), sells an out-of-the-money call and buys an out-of-the-money call (higher strike). Using call options expiring on the same month, the trader can implement a long condor option spread by writing a lower strike in-the-money call, buying an even lower striking in-the-money call, writing a higher strike out-of-the-money call and buying another even higher striking out-of-the-money call. A total of 4 legs are involved in the condor options strategy and a net debit is required to establish the position.

⁷ See Securities Exchange Act Release No. 73023 (September 9, 2014), 79 FR 55033 (September 15, 2014) (SR-ISE-2014-10).

⁸ See Rule 722(b)(3)(ii)(A) – (B).

With rules limiting Non-Standard Strategies from legging into the regular market firmly in place, the risk of market makers trading more than the limitations they have set has greatly diminished. The Exchange therefore proposes to amend Rule 722 to allow complex orders with two, three or four legs (determined by the Exchange on a class basis) to leg into the regular market.⁹

The proposed rule change will allow the Exchange to permit complex order strategies with three or four legs to leg into the regular market as long as all legs are not buying or all legs are not selling. To ensure that such orders do not leg into the regular market, the Exchange proposes to amend Rule 722(b)(3)(ii)(B) to extend the current limitation found in that rule to complex orders with 3 or 4 legs, where all legs are buying or all legs are selling regardless of whether the option is a call or a put. Such orders will only be permitted to trade against other complex orders in the complex order book, as is the case today. The Exchange expects this proposal to loosen the current restriction to result in a number of other legitimate complex order strategies to also be executed on the Exchange.¹⁰

The Exchange previously permitted complex orders that are the subject of this proposal to leg into the regular market and only recently limited that activity to better address the risk posed to market makers. The market maker risk that the Exchange sought to address in the Legging Filing was further strengthened when ISE amended its rules to prevent Non-Standard Strategies from legging into the regular market. With this proposed rule change, complex order strategies, such as Box Spreads and Condors, for example, will once again be permitted to leg

⁹ The Exchange will issue a circular to members identifying the options classes for which legging is limited to complex orders and the associated number of legs. The Exchange will provide members with reasonable notice prior to changing the limit to allow members to make any necessary system changes.

¹⁰ See www.theoptionsguide.com for a more comprehensive list of complex order strategies.

into the regular market and thereby increase the likelihood that these orders are executed on the Exchange rather than on a competing market without posing any unintended risk to market makers. In the Legging Filing, the Exchange noted that over 85% of all complex orders have only two legs. The Exchange notes that current data continues to support that assertion in that even today, over 85% of all complex orders have only two legs and that very few complex orders are entered with more than three legs. The proposed rule change will therefore impact only a small portion of all complex orders traded on the Exchange. These orders, however, are comprised of legitimate trading strategies that have an economic purpose and are not submitted as means to bypass a market maker's risk setting.

2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act¹¹ 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Exchange believes it is reasonable to permit complex orders that are subject of this rule change to leg into the regular market. ISE has codified into its rules the specific complex order strategies that pose the greatest amount of risk to market makers and therefore, the Exchange believes the proposed rule change to permit legitimate multi-legged complex orders to interact with the regular market will promote just and equitable principles of trade. The proposed rule change will facilitate the execution of complex order strategies, such as Box Spreads and Condors, which consist of four legs. The proposed rule change is designed to

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

protect investors and the public interest in that the proposal amends a current rule to ensure that complex orders with three or four option legs where all legs are buying or all legs are selling only trade against other complex orders in the complex order book. The Exchange notes that prior to the Legging Filing and before the Non-Standard Strategies were codified into the Exchange's rules, the complex order strategies affected by this proposal were permitted to trade and leg into the regular market. Therefore, this proposed rule change simply adjusts Exchange rules to once again permit the execution such complex order strategies. The proposed rule change will also benefit investors and the general public because multi-legged strategies will have a greater chance of execution when they are allowed to leg into the regular market and thereby increase the execution rate for these orders thus, providing market participants with an increased opportunity to execute these orders on ISE rather than on a competing exchange.

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

The proposed rule change does not impose any burden on competition. The proposed change to amend the restriction against complex order strategies, such as Box Spreads and Condors, from legging into the regular market will allow a greater number of complex orders to be executed on the Exchange without adversely impacting risk to market makers that are quoting in the regular market.

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 foregoing 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 for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

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.

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-2014-56 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-2014-56. 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 am and 3:00 pm. Copies of the 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-2014-56 and should be submitted on or before [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.¹³

Brent J. Fields
Secretary

¹³ 17 CFR 200.30-3(a)(12).