

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65900; File No. SR-ISE-2011-82)

December 6, 2011

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change Relating to Legging Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 29, 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 add a new order type called “legging orders”. The text of the proposed rule change is as follows (additions are underlined and deletions are [bracketed]):

**Rule 715. Types of Orders**

(a) through (j) no change.

(k) [Reserved.] Legging Orders. A legging order is a limit order on the regular limit order book that represents one side of a complex order that is to buy or sell an equal quantity of two options series resting on the Exchange’s complex order book. Legging orders are firm orders that are included in the Exchange’s displayed best bid or offer.

(1) A legging order may be automatically generated for one leg of a complex order at a price: (i) that matches or improves upon the best displayed bid or offer on the regular limit order book; and (ii) at which the net price can be achieved when the other leg is executed against the best displayed bid or offer on the regular limit order

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

book. A legging order will not be created at a price that locks or crosses the best bid or offer of another exchange.

(2) A legging order is executed only after all other executable orders (including any non-displayed size) and quotes at the same price are executed in full. When a legging order is executed, the other portion of the complex order will be automatically executed against the displayed best bid or offer on the Exchange.

(3) A legging order is automatically removed from the regular limit order book if: (i) the price of the legging order is no longer at the displayed best bid or offer on the regular limit order book, (ii) execution of the legging order would no longer achieve the net price of the complex order when the other leg is executed against the best displayed bid or offer on the regular limit order book, (iii) the complex order is executed in full or in part against another complex order on the complex order book, or (iv) the complex order is cancelled or modified.

(l) and (m) no change.

### ***Supplementary Material to Rule 715***

.01 through .02 no change.

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### **Rule 722. Complex Orders**

(a) no change.

(b) *Applicability of Exchange Rules.* Except as otherwise provided in this Rule, complex orders shall be subject to all other Exchange Rules that pertain to orders generally.

(1) and (2) no change.

(3) *Execution of Orders.* Complex orders will be executed without consideration of any prices that might be available on other exchanges trading the same options contracts.

(i) no change.

(ii) Complex orders will be automatically executed against bids and offers on the Exchange for the individual legs of the complex order provided the complex order can be executed in full or in a permissible ratio by such bids and offers. Legging orders may be automatically generated on behalf of complex orders so that they are represented at the best bid and/or offer on the Exchange for the individual legs as provided in Rule 715(k).

(iii) no change.

(4) No change.

***Supplementary Material to Rule 722***

.01 through .05 no change.

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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 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.

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

1. Purpose

The Exchange proposes to adopt a new order type called "legging orders" to provide additional liquidity for complex orders resting on the complex order book. A complex order resting on the complex order book may be executed either by: (i) trading against an incoming complex order that is marketable against the resting complex order, or (ii) legging into the market when the net price of the complex order can be satisfied by executing all of the legs against the best bids or offers on the Exchange for the individual options series. Legging orders are designed to increase the opportunity for complex orders to leg into the market.

Specifically, a legging order is an order on the regular order book in an individual series that represents a leg of a two-legged complex options order.<sup>3</sup> A legging order may be automatically generated for one leg of a complex order at a price: (i) that matches or improves upon the best displayed bid or offer on the regular limit order book; and (ii) at which the net price can be achieved when the other leg is executed against the best displayed bid or offer on the regular limit order book. For example:

A complex order to buy 10 series 1 (S1) and to buy 10 series 2 (S2) at a net price of \$2.25 (buy S1/S2 10 @ \$2.25) is entered into the complex order book and there is no off-setting complex order to sell.

The complex order cannot leg into the regular market because the BBO net price available for the complex order on the ISE's regular order book is \$2.40 as follows:

	ISE Bid	ISE Offer
S1	10 @ \$1.00	20 @ \$1.20
S2	10 @ \$1.00	20 @ \$1.20

(buy S1 @ \$1.20 + buy S2 @ \$1.20 = \$2.40 net)

Legging orders to buy 10 S1 @ \$1.05 and 10 S2 @ \$1.05 may be automatically generated, improving the ISE's best bid for both S1 and S2 to \$1.05:

	ISE Bid	ISE Offer
S1	10 @ \$1.05 (legging order)	20 @ \$1.20
S2	10 @ \$1.05 (legging order)	20 @ \$1.20

If a marketable order to sell 10 S1 is received, it will execute against the legging order to buy S1 at \$1.05, there will be an automatic execution of the other leg of the complex order against the displayed offer for S2 at \$1.20, and the legging order to buy S2 at \$1.05 will be automatically

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<sup>3</sup> Legging Orders will not be generated for market maker quotes on the complex order book, as such quotes cannot leg into the market. ISE Rule 722, Supplementary Material .03.

cancelled. As a result, the net price of \$2.25 is achieved for the complex order (buy S1 @ \$1.05 + buy S2 @ \$1.20 = \$2.25 net).<sup>4</sup>

Following the execution of the complex order, the ISE BBO is:

	ISE Bid	ISE Offer
S1	10 @ \$1.00	20 @ \$1.20
S2	10 @ \$1.00	10 @ \$1.20

In addition to enabling the execution of the complex order at a net price of \$2.25, the legging order enhanced execution for orders in the regular order book as (i) the incoming marketable order to sell S1 received a better price (\$1.05 instead of \$1.00), and (ii) liquidity to execute resting interest to sell 10 S2 at \$1.20 was provided by the complex order.

A legging order is executed only after all other executable orders (including any non-displayed size) and quotes at the same price are executed in full. Accordingly, the generation of a legging order will not affect the existing priority, or execution opportunities, currently provided to participants in the regular market in any way. For example:

A complex order to buy 50 S1 and to buy 50 S2 at a net price of \$2.25 (buy S1/S2 50 @ \$2.25) is entered into the complex order book and there is no off-setting complex order to sell.

The complex order cannot leg into the regular market because the BBO net price available for the complex order on the ISE's regular order book is \$2.40 as follows:

	ISE Bid	ISE Offer
S1	40 @ \$1.05	60 @ \$1.20
S2	20 @ \$1.05	80 @ \$1.20

(buy S1 @ \$1.20 + buy S2 @ \$1.20 = \$2.40 net)

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<sup>4</sup> If a marketable order to sell 10 S2 is received, it will execute against the legging order to buy S2 at \$1.05, there will be an automatic execution of the other leg of the complex order against the displayed offer for S1 at \$1.20, and the legging order to buy S1 at \$1.05 will be automatically cancelled. As a result, the net price of \$2.25 is achieved for the complex order (buy S1 @ \$1.20 + buy S2 @ \$1.05 = \$2.25 net).

Legging orders to buy 50 S1 @ \$1.05 and 50 S2 @ \$1.05 may be automatically generated, increasing the size of the ISE's best bid for both S1 and S2 as follows:

	ISE Bid	ISE Offer
S1	90 @ \$1.05 (50 legging order)	60 @ \$1.20
S2	70 @ \$1.05 (50 legging order)	80 @ \$1.20

If a marketable order to sell 30 S1 is received, it will execute against the orders and/or quotes at \$1.05 other than the legging order pursuant to the Exchange's regular allocation algorithm,<sup>5</sup> and the size of the bid for S1 will be reduced to 60 contracts as follows:

	ISE Bid	ISE Offer
S1	60 @ \$1.05 (50 legging order)	60 @ \$1.20
S2	70 @ \$1.05 (50 legging order)	80 @ \$1.20

If a marketable order to sell 50 S1 were then received, it will first execute the remaining 10 S1 from the orders and/or quotes at \$1.05 that are not the legging order, and then execute 40 S1 against the legging order.

At this time, the complex order will also execute 40 S2 at \$1.20, and the legging order to buy 50 S2 will be reduced automatically to 10 contracts. As a result, the net price of \$2.25 is achieved for a partial execution of the complex order (buy 40 S1 @ \$1.05 + buy 40 S2 @ 1.20 = 40 @ \$2.25 net).

Following the partial execution of the complex order, the ISE BBO is:

	ISE Bid	ISE Offer
S1	10 @ \$1.05 (legging order)	60 @ \$1.20
S2	30 @ \$1.05 (10 legging order)	40 @ \$1.20

A legging order will be removed from the regular limit order book automatically if: (i) the price of the legging order is no longer at the displayed best bid or offer on the Exchange's

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<sup>5</sup> See ISE Rule 713.

regular limit order book, (ii) execution of the legging order would no longer achieve the net price of the complex order when the other leg is executed against the best displayed bid or offer on the regular limit order book, (iii) the complex order is executed in full or in part against another complex order on the complex order book, or (iv) the complex order is cancelled or modified.

For example:

A complex order to buy 20 S1 and to buy 20 S2 at a net price of \$2.25 (buy S1/S2 20 @ \$2.25) is entered into the complex order book and there is no off-setting complex order to sell.

The complex order cannot leg into the regular market because the BBO net price available for the complex order on the ISE's regular order book is \$2.40 as follows:

	ISE Bid	ISE Offer
S1	10 @ \$1.05	20 @ \$1.20
S2	10 @ \$1.05	50 @ \$1.20

(buy S1 @ \$1.20 + buy S2 @ \$1.20 = \$2.40 net)

Legging orders to buy 20 S1 @ \$1.05 and 20 S2 @ \$1.05 may be automatically generated, increasing the size of the ISE's best bid for both S1 and S2 as follows:

	ISE Bid	ISE Offer
S1	30 @ \$1.05 (20 legging order)	20 @ \$1.20
S2	30 @ \$1.05 (20 legging order)	50 @ \$1.20

If a limit order to buy 10 S1 @ \$1.10 is received, the legging order to buy 20 S1 at \$1.05 will be cancelled because it is no longer at the ISE best bid.

	ISE Bid	ISE Offer
S1	10 @ \$1.10	20 @ \$1.20
S2	30 @ \$1.05 (20 legging order)	50 @ \$1.20

If a marketable order to buy 20 S1 is received, the ISE best offer will move above \$1.20, resulting in the cancellation of the legging order to buy S2 at \$1.05 because the net price of \$2.25 can no longer be achieved.

	ISE Bid	ISE Offer
S1	10 @ \$1.10	10 @ \$1.25
S2	10 @ \$1.05	50 @ \$1.20

(buy S1 @ \$1.25 + buy S2 at \$1.05 = \$2.30 net)

The proposed rule specifies when a legging order can be generated. Specifically, legging orders may be generated only for simple two-legged options orders with the same quantity on both legs, and there can be only one legging order to buy in a series. Moreover, legging orders will not be generated at a price that would lock or cross the price of an away market. In addition to these limitations, the Exchange will carefully manage and curtail the number of legging orders being generated so that they do not negatively impact system capacity and performance.<sup>6</sup> Accordingly, legging orders may not be generated for all eligible complex orders resting on the complex order book.

## 2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under requirement under [sic] Section 6(b),<sup>7</sup> in general, and Section 6(b)(5)<sup>8</sup> in particular, 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. The Exchange believes that the proposal is reasonably designed

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<sup>6</sup> The ISE will curtail the number of legging orders on an objective basis, such as limiting the number of orders generated in a particular class. The Exchange will not limit the generation of legging orders on the basis of the entering participant or the participant category of the order (i.e., professional, professional customer, or public customer).

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

to benefit investors by increasing the opportunity for complex orders to receive an execution, while also enhancing execution quality for orders in the regular market.

In particular, the Exchange believes that automatically generating legging orders, which will only be executed after all other executable interest at the same price (including non-displayed interest) is executed in full, will provide additional execution opportunities for complex orders, without negatively impacting any investors in the regular market. In fact, the generation of legging orders may enhance execution quality for investors in the regular market by improving the price and/or size of the ISE BBO and by providing additional execution opportunity for resting orders on the regular order book.

The Exchange also believes that the generation of legging orders is fully compliant with all regulatory requirements. In particular, legging orders are firm orders that will be displayed at the ISE BBO. A legging order will be automatically removed if it is no longer displayable at the ISE BBO or if the net price of the complex order can no longer be achieved. Moreover, to assure compliance with intermarket rules, a legging order will not be generated at a price that would lock or cross another market. Finally, the generation of legging orders is limited in scope, as they may be generated only for complex options orders with two legs. Additionally, the Exchange will closely manage and curtail the generation of legging orders to assure that they do not negatively impact system capacity and performance.

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.

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 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](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2011-82 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-2011-82. 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-2011-82 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.<sup>9</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>9</sup> 17 CFR 200.30-3(a)(12).