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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-66234; File No. SR-ISE-2011-82)

January 25, 2012

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Approving a Proposed Rule Change Relating to Legging Orders

I. Introduction

On November 29, 2011, the International Securities Exchange, LLC (the “Exchange” or “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”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend ISE Rule 715, “Types of Orders,” to add a new order type, the legging order. The proposed rule change was published for comment in the Federal Register on December 12, 2011.<sup>3</sup> The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change.

II. Description

A complex order resting on ISE’s 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 of the complex order against the best bids or offers on ISE for the

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

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

<sup>3</sup> See Securities Exchange Act Release No. 65900 (December 6, 2011), 76 FR 77275 (“Notice”).

individual options series. ISE's new order type, the legging order, is designed to increase the opportunities for a complex order resting on ISE's complex order book to leg into the market.<sup>4</sup>

Under the proposal, a legging order may be generated automatically on behalf of one leg of a complex order resting on ISE's complex order book at a price: (i) that matches or improves the best displayed bid or offer on ISE's regular limit order book; and (ii) at which the net price of the complex order can be achieved when the other leg of the complex order executes against the best displayed bid or offer on ISE's regular limit order book.<sup>5</sup> When a legging order representing one leg of the complex order is executed, the other leg of the complex order will execute automatically against ISE's displayed best bid or offer.<sup>6</sup>

A legging order will be removed automatically from ISE's regular limit order book if: (i) the price of the legging order is no longer at the displayed best bid or offer on the Exchange's 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.<sup>7</sup>

Legging orders are firm orders that will be included in ISE's displayed best bid or offer.<sup>8</sup>

A legging order will be executed only after all other executable orders (including any non-

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<sup>4</sup> Legging orders will not be generated for market maker quotes on the complex order book because market maker quotes cannot leg into the market. See ISE Rule 722, Supplementary Material .03.

<sup>5</sup> See ISE Rule 715(k)(1).

<sup>6</sup> See ISE Rule 715(k)(2).

<sup>7</sup> See ISE Rule 715(k)(3).

<sup>8</sup> See ISE Rule 715(k).

displayed size) and quotes at the same price are executed in full.<sup>9</sup> Accordingly, ISE notes that the generation of a legging order will not affect the existing priority, or execution opportunities, currently provided to participants in the regular market.<sup>10</sup>

The proposal limits the circumstances under which a legging order may be generated. A legging order may be generated only on behalf of a two-legged complex that has an equal number of contracts on both legs, and a legging order will not be created at a price that would lock or cross the best bid or offer of another exchange.<sup>11</sup> There can be only one legging order to buy in a series.<sup>12</sup>

In addition to these limitations, ISE states that it will carefully manage and curtail the number of legging orders being generated so that they do not negatively impact system capacity and performance.<sup>13</sup> Accordingly, legging orders may not be generated for all eligible complex orders resting on the complex order book.<sup>14</sup> ISE represents that it will curtail the number of legging orders on an objective basis, such as by limiting the number of orders generated in a particular class.<sup>15</sup> ISE represents, further, that it 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>16</sup>

The following example illustrates the operation of legging orders:

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<sup>9</sup> See ISE Rule 715(k)(2).

<sup>10</sup> See Notice, 76 FR at 77276.

<sup>11</sup> See ISE Rule 715(k) and (k)(1).

<sup>12</sup> See Notice, 76 FR at 77276.

<sup>13</sup> See id.

<sup>14</sup> See id.

<sup>15</sup> See Notice, 76 FR at 77276, footnote 6.

<sup>16</sup> See id.

A complex order to buy 10 series 1 (S1) and 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 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 generated automatically, improving ISE's best bid for both S1 and S2 to \$1.05:

|    | ISE Bid                        | ISE Offer   |
|----|--------------------------------|-------------|
| S1 | 10 @ \$1.05<br>(legging order) | 20 @ \$1.20 |
| S2 | 10 @ \$1.05<br>(legging order) | 20 @ \$1.20 |

If ISE receives a marketable order to sell 10 S1, it would execute against the legging order to buy S1 at \$1.05, the other leg of the complex order would execute automatically against the displayed offer of \$1.20 for S2, and the legging order to buy S2 at \$1.05 would be cancelled automatically. This would achieve the net price of \$2.25 for the complex order (buy S1 @ \$1.05 + buy S2 @ \$1.20 = \$2.25 net).<sup>17</sup>

ISE notes that, in this example, the legging order enabled the execution of the complex order at a net price of \$2.25 and enhanced the execution of the interest in the leg market because (i) the incoming marketable order to sell S1 received a better price (\$1.05 instead of \$1.00), and

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<sup>17</sup> If ISE received a marketable order to sell 10 S2, it would execute against the legging order to buy S2 at \$1.05, the other leg of the complex order would execute automatically against the displayed offer of \$1.20 for S1, and the legging order to buy S1 at \$1.05 would be cancelled automatically. This would achieve the net price of \$2.25 for the complex order (buy S1 @ \$1.20 + buy S2 @ \$1.05 = \$2.25 net). For additional examples regarding the operation of legging orders, see Notice, 76 FR at 77275 – 77276.

(ii) the complex order provided liquidity to execute the resting leg market interest to sell S2 at \$1.20.<sup>18</sup>

### III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>19</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>20</sup> 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.

The Commission believes that the proposed rule change could facilitate the execution of complex orders resting on ISE's complex order book by increasing the opportunities for these orders to execute against interest in the leg market, thereby benefitting investors seeking to execute complex orders. In addition, the Commission believes that the proposal could benefit participants in the leg market by providing additional liquidity, and potentially more favorable executions, for orders and quotes in the leg market.

A legging order is a firm order that will be included in ISE's displayed best bid or offer.<sup>21</sup> In addition, a legging order will not be created at a price that would lock or cross the best bid or

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<sup>18</sup> See Notice, 76 FR at 77276.

<sup>19</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> See ISE Rule 715(k).

offer of another exchange.<sup>22</sup> The Commission notes that a legging order will be executed only after all other executable orders (including any non-displayed size) and quotes at the same price are executed in full.<sup>23</sup> Accordingly, ISE states that legging orders will not affect the existing priority, or execution opportunities, of participants in the leg market.<sup>24</sup>

As noted above, ISE represents that it will carefully manage and curtail the number of legging orders being generated so that they do not negatively impact system capacity and performance.<sup>25</sup> ISE represents, further, that it will curtail the number of legging orders on an objective basis, such as by limiting the number of orders generated in a particular class, and that it 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>26</sup>

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<sup>22</sup> See ISE Rule 715(k)(1).

<sup>23</sup> See ISE Rule 715(k)(2).

<sup>24</sup> See Notice, 76 FR at 77276.

<sup>25</sup> See id.

<sup>26</sup> See id.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (SR-ISE-2011-82) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>28</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> 17 CFR 200.30-3(a)(12).