ISE
INTERNATIONAL SECURITIES EXCHANGE

Regulatory Information Circular – 2001-15

To: ISE Members

Date: October 24, 2001

Re: **Complex Orders**

On October 18, 2001, the Securities and Exchange Commission approved new ISE Rule 722, Complex Orders. (Securities Exchange Act Release No. 44955 (October 18, 2001). The full text of Rule 722 is attached.

Functionality is being introduced for trading complex orders that are priced on the basis of a total credit or debit ("net price") with the implementation of API Version 16.5 on October 29, 2001. (See Technical Bulletins 2001-6 and 2001-11 for further description of the technical aspects of complex order trading.) New Rule 722 sets forth the priority and order handling principles that apply to these net-priced complex orders. The following is a summary of those principles and other aspects of complex order functionality:

- All members are eligible to enter and trade against complex orders.
- A "complex order" is an order entered for the same account which is either a spread, straddle, strangle, combination, ratio, butterfly spread, box spread or a collar order. Each of these types of complex orders are defined in the rule, and each multi-leg order entered into the system must meet one of these definitions.
- Complex orders can have two, three or four legs. All complex orders are limit orders, which may be entered as a GTC or day order, or with a particular time interval after which the order will be automatically canceled. Complex orders also can be entered as all-or-none.
- There will be a separate complex limit order book that will display complex orders, including the legs of the trade and the net price. In this initial phase of the complex order functionality, orders will not automatically match with quotes and orders in the regular market, nor will orders match against each other in this separate book unless a member selects or "clicks on" a particular order for execution.
- If a complex order is entered without a net price (an "interest order"), it will be displayed, but it will not be available for execution in the system. A member seeking to provide a price for such an order must enter its own complex order matching the terms of the interest order with a net price. The member who entered the interest order can then execute against the net-priced order.

- The execution rules for complex orders are similar to those on the other options exchanges. The system will not allow a complex order to be executed at a net price that requires any leg of the trade to be executed at a price that is inferior to the ISE best bid or offer. In addition, the system will not allow a complex order to be executed at a net price that requires a leg of the trade to be executed at the same price as the ISE best bid or offer if there is a Public Customer order on the book at that price, *unless* at least one other leg of the trade is executed at a price that improves upon the ISE best bid or offer. However, complex orders can be executed at a net price that requires the legs of the trade to be executed at the same price as the ISE best bid or offer ("at the corners") without restriction if there are no Public Customer orders on the book. There is no away-market price protection for complex orders.

- During this first phase of complex order functionality, a complex order will be executed only if the net price can be achieved in a multiple of the minimum tick applicable to the individual legs of the order.

- There is no "facilitation mechanism" available for complex orders. However, there is an exception to the 30 second exposure requirement contained in Rule 717(d) for complex orders if at least one of the legs is for 50 contract or more. Under the exception, an entering firm is permitted to execute up to 40% of a complex order as principal immediately upon the order's entry. The remaining portion of the order then must be exposed for at least 30 seconds before the entering firm may execute it as principal.

- Complex orders are not subject to the restrictions on order entry pertaining to the electronic generation of orders and multiple orders for the same beneficial account contained in Rules 717(f) and (h).

Any questions regarding the foregoing may be directed to the attention of Katherine Simmons, Vice President and Associate General Counsel (212-897-0233 or ksimmons@iseoptions.com) or Jennifer Lamie, Assistant General Counsel (212-897-0234 or jlamie@iseoptions.com).

Text of the Rule

Rule 722. Complex Orders

(a) *Complex Orders Defined.* A complex order is any order for the same account as defined below:

(1*) Spread Order*. A spread order is an order to buy a stated number of option contracts and to sell the same number of option contracts, of the same class of options.

(2) *Straddle Order*. A straddle order is an order to buy (sell) a number of call option contracts and the same number of put option contracts on the same underlying security which contracts have the same exercise price and expiration date (e.g., an order to buy two XYZ July 50 calls and to buy two XYZ July 50 puts).

(3) *Strangle Order*. A strangle order is an order to buy (sell) a number of call option contracts and the same number of put option contracts in the same underlying security, which contracts have the same expiration date (e.g., an order to buy two ABC June 40 calls and to buy two ABC June 35 puts).

(4) *Combination Order.* A combination order is an order involving a number of call option contracts and the same number of put option contracts in the same underlying security and representing the same number of shares at option.

(5) *Stock-Option Order*. A stock-option order is an order to buy or sell a stated number of units of an underlying stock or a security convertible into the underlying stock ("convertible security") coupled with either (i) the purchase or sale of option contract(s) on the opposite side of the market representing either the same number of units of the underlying stock or convertible security or the number of units of the underlying stock necessary to create a delta neutral position; or (ii) the purchase or sale of an equal number of put and call option contracts, each having the same exercise price, expiration date, and each representing the same number of units of stock, as and on the opposite side of the market from, the stock or convertible security portion of the order.

(6) *Ratio Order*. A spread, straddle or combination order may consist of a different number of contracts, so long as the number of contracts differs by a permissible ratio. For purposes of this paragraph, a permissible ratio of contracts is any of the following: one-to-one, one-to-two and two-to-three.

(7) *Butterfly Spread Order.* A butterfly spread order is an order involving three series of either put or call options all having the same underlying security and time of expiration and, based on the same current underlying value, where the interval between the exercise price of each series is equal, which

orders are structured as either (i) a “long butterfly spread” in which two short options in the same series offset by one long option with a higher exercise price and one long option with a lower exercise price or (ii) a “short butterfly spread” in which two long options in the same series are offset by one short option with a higher exercise price and one short option with a lower exercise price.

(8) *Box Spread Order.* A box spread order is an order involving (a) a long call option and a short put option with the same exercise price, coupled with (b) a long put option and a short call option with the same exercise price; all of which have the same underlying security and time of expiration.

(9) *Collar Order*. A collar order is an order involving the sale of a call option coupled with the purchase of a put option in equivalent units of the same underlying security having a lower exercise price than, and same expiration date as, the sold call option.

(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) *Minimum Increments.* Bids and offers on complex orders may be expressed in any decimal price regardless of the minimum increments otherwise appropriate to the individual legs of the order. Complex orders expressed in net price increments that are not multiples of the minimum increment are not entitled to the same priority under subparagraph (b)(2) of this Rule as such orders expressed in increments that are multiples of the minimum increment.

(2) *Complex Order Priority*. Notwithstanding the provisions of Rule 713, a complex order, as defined in paragraph (a) of this Rule, may be executed at a total credit or debit price with one other member without giving priority to bids or offers established in the marketplace that are no better than the bids or offers comprising such total credit or debit; provided, however, that if any of the bids or offers established in the marketplace consist of a Public Customer limit order, the price of at least one leg of the complex order must trade at a price that is better than the corresponding bid or offer in the marketplace. Under the circumstances described above, the option leg of a stock-option order, as defined in subparagraph (a)(5)(i) of this Rule, has priority over bids and offers established in the marketplace by Non-Customer orders and market maker quotes that are no better than the price of the options leg, but not over such bids and offers established by Public Customer Orders. The option legs of a stock-option order as defined in subparagraph (a)(5)(ii), consisting of a combination order with stock, may be executed in accordance with the first sentence of this subparagraph (b)(2).

(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.

(4) *Types of Complex Orders.* Complex orders may be entered as fill-or-kill or immediate-or-cancel orders, as defined in Rule 715(b), or as all-or-none orders, which are resting limit orders to be executed in their entirety or not at all.

(5) *Limitations on Complex Orders.*

(i) For any complex order where one leg alone is at least fifty (50) contracts, a member may execute as principal up to forty percent (40%) of an order it represents as agent without complying with the thirty (30) second exposure requirement contained in Rule 717(d)(i) and (ii).

(ii) For any complex order where one leg alone is at least fifty (50) contracts, a member may execute up to forty percent (40%) of an order it represents as agent against an order solicited from a Member or non-member broker-dealer to transact with such order without complying with the thirty (30) second exposure requirement contained in Rule 717(e).

(iii) The restrictions on order entry contained in paragraphs (f) and (h) of Rule 717 shall not apply to complex orders.

Supplementary Material to Rule 722

.01 This Rule 722 will be in effect until October 18, 2002.

[Adopted October 18, 2001 (SR-ISE-2001-18).]