

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

**Kevin M. O'Neill,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-72359; File No. SR-ISE-2014-10]

### Self-Regulatory Organizations; International Securities Exchange, LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change Related to Limiting Certain Types of Complex Orders From Legging Into the Regular Market

June 10, 2014.

#### I. Introduction

On February 25, 2014, 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 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change relating to complex orders. The proposed rule change was published for comment in the **Federal Register** on March 14, 2014.<sup>3</sup> The Commission received no comment letters. On April 23, 2014, the Commission extended the time period in which to either approve the proposal, disapprove the proposal, or to institute proceedings to determine whether to approve or disapprove the proposal, to June 12, 2014.<sup>4</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>5</sup> to determine whether to approve or disapprove the proposal.

#### II. Description of the Proposal

The Exchange proposes to amend ISE Rule 722 to prohibit certain types of complex orders from legging into the regular market (*i.e.*, executing against individual quotes for each of the legs of the complex order in the regular market).<sup>6</sup> Specifically, ISE proposes that

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 will only trade against other complex orders in the complex order book and will not be permitted to leg into the regular market.<sup>7</sup> ISE also proposes that complex orders with three option legs where all legs are buying or all legs are selling, regardless of whether the options are a calls or puts, will only trade against other complex orders in the complex order book and will not be permitted to leg into the regular market.<sup>8</sup> ISE describes these types of two and three leg complex order strategies as “atypical” complex order strategies in that they are geared toward an aggressive directional capture of volatility.<sup>9</sup>

The Exchange further proposes to amend ISE Rule 722 to prevent legging orders<sup>10</sup> from being generated on behalf of the two-legged complex orders where both legs are buying or both legs are selling and both legs are calls or both legs are puts.<sup>11</sup> According to the Exchange, preventing the generation of legging orders for these types of two-legged complex orders is necessary to effectuate the proposed limitation to exclude these types of complex orders from trading in the regular market.<sup>12</sup>

In addition, the Exchange proposes to amend Supplemental Material .08 to Rule 716 (Facilitation Mechanism and

legs) 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 while maintaining a permissible ratio by such bids and offers.

<sup>7</sup> See Notice, *supra* note 3, at 14564. The Exchange offers some examples of such strategies as follows: (i) Buy Call 1, Buy Call 2; (ii) Sell Call 1, Sell Call 2; (iii) Buy Put 1, Buy Put 2; (iv) Sell Put 1, Sell Put 2. See *id.*

<sup>8</sup> See *id.* The Exchange offers some examples of such strategies as follows: (i) Buy Call 1, Buy Call 2, Buy Put 1; (ii) Buy Put 1, Buy Put 2, Buy Put 3; (iii) Buy Call 1, Buy Call 2, Buy Call 3; (iv) Buy Put 1, Buy Put 2, Buy Call 3; (v) Sell Put 1, Sell Put 2, Sell Call 1. See *id.*

<sup>9</sup> See *id.* Hereinafter these two and three legged complex order strategies that are the subject of this proposal will be referred to as “directional complex orders.” ISE states that most traditional complex order strategies used by retail or professional investors, unlike directional complex orders, seek to hedge the potential move of the underlying security or to capture a premium from an anticipated market event. See *id.*

<sup>10</sup> ISE Rule 715(k) defines a legging order as 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.

<sup>11</sup> See Notice, *supra* note 3, at 14565. The Exchange notes that legging orders cannot be generated for complex orders with three options legs, and, therefore, is not proposing to prevent the generation of legging orders for complex orders with three option legs where all legs are buying or all legs are selling, regardless of whether the options are calls or puts. See *id.*

<sup>12</sup> See *id.*

Solicited Order Mechanism) and Supplemental Material .10 to Rule 723 (Price Improvement Mechanism) to ensure that directional complex orders do not leg into the regular market through an auction.<sup>13</sup> ISE represents that, under its current rules, if an improved net price for a complex order in the Exchange’s auctions can be achieved from bids and offers for the individual legs of the complex order in the regular market, the complex order would receive that better net price.<sup>14</sup> ISE proposes to prevent directional complex orders from interacting with the regular market during an auction in connection with the Exchange’s proposal in order to prevent directional complex orders from executing against the regular market.<sup>15</sup> Accordingly, the Exchange proposes to amend Supplemental Material .08 to Rule 716 and Supplemental Material .10 to Rule 723 to provide that if an improved net price can be achieved from bids and offers for the individual legs for directional complex orders during an auction, ISE will cancel the auction at the end of the auction’s exposure period.<sup>16</sup>

According to the Exchange, the proposed rule amendments are designed to prevent directional complex orders from bypassing the Exchange’s market maker risk parameters for the regular market.<sup>17</sup> ISE states that the market maker risk parameters are designed to automatically remove a market maker’s quotes in all series of an options class when any of four parameter settings established by the market maker are triggered.<sup>18</sup> ISE describes these market maker risk parameters as a functionality that allows market makers to provide liquidity across many different options series without being at risk of executing the full cumulative size of all of their quotes before being given adequate opportunity to adjust their quotes.<sup>19</sup> According to ISE, when a complex order legs into the regular market, all of the legs of a complex order are considered as a single transaction for purposes of the market maker risk parameters, and not as a series of individual transactions.<sup>20</sup> Thus, the trading system performs the market maker risk parameter calculations after the entire

<sup>13</sup> See *id.*

<sup>14</sup> See *id.*

<sup>15</sup> See Notice, *supra* note 3, at 14565.

<sup>16</sup> See *id.*

<sup>17</sup> See *id.* at 14564 and ISE Rule 804(g) (Automated Quotation Adjustments). See also Supplemental Material .04 to ISE Rule 722 (Automated Spread Quotation Adjustments).

<sup>18</sup> See Notice, *supra* note 3, at 14564.

<sup>19</sup> See *id.*

<sup>20</sup> See *id.*

<sup>15</sup> 17 CFR 200.30-3(a)(12).

<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. 71669 (March 10, 2014), 79 FR 14563 (“Notice”).

<sup>4</sup> See Securities Exchange Act Release No. 72006 (April 23, 2014), 79 FR 24031 (April 29, 2014).

<sup>5</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>6</sup> See Notice, *supra* note 3, at 14564. ISE Rule 722(b)(3)(ii) rule states that complex orders up to a maximum number of legs (determined by the Exchange on a class basis as either two legs or three

complex order executes against interest in the regular market. According to the Exchange, the manner in which complex orders leg into the regular market may cause market makers to trade above limits set in their market maker risk parameters.<sup>21</sup> As a result, the Exchange believes that market makers may alter their trading behavior to account for the additional risk by widening quotes, hurting the Exchange's quality of markets and the quality of markets in general.<sup>22</sup> Further, according to ISE, directional complex orders that bypass market makers' risk parameters may result in artificially large transactions that distort the market for related instruments, including the underlying security or related options series.<sup>23</sup> The Exchange believes that the potential risk to market makers of allowing directional complex orders to execute against market makers' quotes in the regular market outweighs the potential benefit of allowing directional orders to execute against interest in the regular market.<sup>24</sup> By limiting directional complex orders from legging into the regular market, the Exchange believes that market makers will post tighter and more liquid markets for regular orders and traditional complex orders, while reducing the frequency and size of related market distortions.<sup>25</sup>

Finally, ISE represents that directional complex orders may trade against other complex order in the ISE complex order book and may rest on the ISE complex order book until they are traded or canceled by the member that entered them.<sup>26</sup>

### III. Proceedings to Determine Whether to Approve or Disapprove SR-ISE-2014-10 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>27</sup> to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change, as discussed below. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as

described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>28</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with Section 6(b)(5) of the Act, which require that the rules of a national securities exchange be designed, among other things, 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; and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.<sup>29</sup>

### IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any other concerns they may have with the proposed rule change. In particular, the Commission invites the written views of interested persons concerning whether the proposal is consistent with Section 6(b)(5)<sup>30</sup> or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an oral presentation.<sup>31</sup>

<sup>28</sup> *Id.* Section 19(b)(2)(B) of the Exchange Act also provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. *See id.* The time for conclusion of the proceedings may be extended for up to 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding. *See id.*

<sup>29</sup> 15 U.S.C. 78f(b)(5).

<sup>30</sup> *Id.*

<sup>31</sup> Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Public Law 94-29 (June 4, 1975), grants the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. *See* Securities Act Amendments of 1975, Senate Comm. on Banking, Housing & Urban

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by July 7, 2014. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by July 21, 2014. The Commission asks that commenters address the sufficiency and merit of the Exchange's statements in support of the proposed rule change, in addition to any other comments they may wish to submit about the proposed rule change. In particular, the Commission seeks comment on the following:

1. What are commenters' views on ISE's proposal to limit directional complex orders from legging into the regular market? Please explain.

a. What are commenters' views on ISE's proposal to prevent legging orders from being generated on behalf of directional complex orders? Please explain.

b. What are commenters' views on ISE's proposal to cancel an auction at the end of the auction's exposure period if an improved net price can be achieved from bids and offers for the individual legs of a directional complex during an auction? Please explain.

2. Do commenters agree with ISE's assertion that complex orders with two options 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 are selling, regardless of whether the options are calls or puts, are not traditional complex order strategies used by retail or professional investors? Why or why not? Do commenters agree with ISE's assertion that such complex orders are primarily geared towards an aggressive directional capture of volatility? Why or why not?

3. According to the Exchange, to account for the additional risk presented by the execution of directional complex orders, market makers in the regular market may change their trading behavior by widening quotes. Do commenters agree with ISE's assertion that market makers in the regular market would alter their trading behavior by widening their quotes to account for the risk presented by the execution of directional complex orders? Why or why not? Are market makers currently altering their trading behavior in such a manner? Please explain, and, to the extent possible, provide supporting data.

Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

<sup>21</sup> *See id.*

<sup>22</sup> *See id.*

<sup>23</sup> *See id.*

<sup>24</sup> *See* Notice, *supra* note 3, at 14565. ISE notes that the number of directional complex orders is small relative to the total number of complex orders executed on the Exchange on a given day. *See id.*

<sup>25</sup> *See id.*

<sup>26</sup> *See id.*

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

4. Do commenters agree with ISE's assertion that market makers in the regular market would reduce the size of their quotations across multiple options series in the regular market because they are at risk of executing the cumulative size of their quotations without an opportunity to adjust their quotes? Please explain, and, to the extent possible, provide supporting data.

5. Do commenters agree with ISE's assertion that the execution of directional complex orders could result in artificially large transactions that distort the market for other related instruments, including the underlying security or related options series? Why or why not? Please explain, and, to the extent possible, provide supporting data.

6. According to the Exchange, the proposed rule change is designed to limit a market maker's risk against executions of directional complex orders. Please provide data, if available, showing how the execution of such complex orders against market maker quotes in the regular market affects a market maker's risk exposure.

7. Do commenters agree with ISE's assertion that the number of directional complex orders is small relative to the total number of complex orders executed on ISE on a given day? Why or why not? Please explain, and, to the extent possible, provide supporting data.

8. Do commenters agree with ISE's assertion that the potential risk to market makers in the regular market of allowing directional complex orders to leg into the regular market outweighs the potential benefits of continuing to allow directional complex orders to interact with the regular market? Why or why not? Please explain, and, to the extent possible, provide supporting data.

9. Do commenters agree with ISE's assertion that the proposed rule change would encourage market makers to provide tighter and more liquid markets on the Exchange? Why or why not? Please explain, and, to the extent possible, provide supporting data.

10. Do commenters believe that any potential benefits to investors resulting from ISE's proposal would exceed any benefits of continuing to allow directional complex orders to interact with the regular market? Why or why not? Please explain, and, to the extent possible, provide supporting data.

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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2014-10 on the subject line.

#### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-ISE-2014-10. This file number should be included on the subject line if email 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the accommodation proposal that are filed with the Commission, and all written communications relating to the accommodation proposal 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 Web site 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 such filings 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-2014-10 and should be submitted on or before July 7, 2014. Rebuttal comments should be submitted by July 21, 2014.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>32</sup>

**Kevin M. O'Neill,**  
Deputy Secretary.

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#### DEPARTMENT OF STATE

[Public Notice: 8765]

#### Culturally Significant Object Imported for Exhibition Determinations: "Magna Carta: Cornerstone of Liberty," "Radical Words: From the Magna Carta to the Constitution" and "Magna Carta: Muse and Mentor" Exhibitions

**SUMMARY:** Notice is hereby given of the following determinations: Pursuant to the authority vested in me by the Act of October 19, 1965 (79 Stat. 985; 22 U.S.C. 2459), Executive Order 12047 of March 27, 1978, the Foreign Affairs Reform and Restructuring Act of 1998 (112 Stat. 2681, *et seq.*; 22 U.S.C. 6501 note, *et seq.*), Delegation of Authority No. 234 of October 1, 1999, Delegation of Authority No. 236-3 of August 28, 2000 (and, as appropriate, Delegation of Authority No. 257 of April 15, 2003), I hereby determine that the object to be included in the exhibition "Magna Carta: Cornerstone of Liberty" at the Museum of Fine Arts; the exhibition "Radical Words: From the Magna Carta to the Constitution" at the Sterling and Francine Clark Art Institute, and exhibition "Magna Carta: Muse and Mentor" at the Library of Congress, imported from abroad for temporary exhibition within the United States, is of cultural significance. The object is imported pursuant to a loan agreement with the foreign owner or custodian. I also determine that the exhibition or display of the exhibit object at the Museum of Fine Arts, Boston, MA, from on or about July 2, 2014, until on or about September 1, 2014; the Sterling and Francine Clark Art Institute, Williamstown, MA, from on or about September 6, 2014, until November 2, 2014, and the Library of Congress, Washington, DC, from November 6, 2014, until on or about January 19, 2015, and at possible additional exhibitions or venues yet to be determined, is in the national interest. I have ordered that Public Notice of these Determinations be published in the **Federal Register**.

**FOR FURTHER INFORMATION CONTACT:** For further information, including a list of the exhibit object, contact Julie Simpson, Attorney-Adviser, Office of the Legal Adviser, U.S. Department of State (telephone: 202-632-6467). The mailing address is U.S. Department of State, SA-5, L/PD, Fifth Floor (Suite 5H03), Washington, DC 20522-0505.

<sup>32</sup> 17 CFR 200.30-3(a)(57).