Regulatory Information Circular – 2002-17

To: ISE Members

Date: October 17, 2002

Re: **Complex Order Rule Change**

The SEC has granted permanent approval for ISE Rule 722 regarding complex orders, with one change to the rule. During the pilot period, Rule 722(b)(5)(i) and (ii) permitted members to execute up to 40% of an order without complying with the 30 second exposure requirement contained in Rule 717(d) and (e). The permanent approval of Rule 722 does not include these provisions.

Effective October 21, 2002, members must expose the entire size of their complex orders for at least 30 seconds before entering a contra-side proprietary order or a contra- side order that has been solicited from a broker-dealer, as required under Rule 717(d) and (e).

The text of Rule 722 as amended is attached hereto.

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Questions regarding this notice may be directed to Katherine Simmons, Vice President, Legal & Regulatory Department, and Associate General Counsel, at (212) 897-0233.

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) *Combination orders with non-equity options legs.* One or more legs of a complex order may be to purchase or sell a stated number of units of another security.

(i) *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 (A) 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 (B) 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.

(ii) *SSF-Option Order.* A SSF-option order is an order to buy or sell a stated number of units of a single stock future or a security convertible into a single stock future ("convertible SSF") coupled with either (A) the purchase or sale of option contracts(s) on the opposite side of the market representing either the same number of units of stock underlying the single stock future or convertible SSF, or the number of units of stock underlying the single stock future or convertible SSF necessary to create a delta neutral position; or (B) 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 underlying stock, as and on the opposite side of the market from, the stock underlying the single stock future or convertible SSF portion of the order.

(6) *Ratio Order*. A spread, straddle or combination order may consist of legs that have 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 ratio that is equal to or greater than .5. For example, a one-to-two ratio (which is equal to .5) and a six-to-ten ratio (which is equal to .6) are permitted, but a one-to-three ration (which is equal to .33) is not.

(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.* 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 A bid or offer made as part of a stock-option order, as defined in (a)(5) above, is made and accepted subject to the following conditions: (1) the stock-option order must disclose all legs of the order and must identify the price at which the non-option leg(s) of the order is to be filled; and (2) concurrent with the execution of the options leg of the order, the initiating member and each member that agrees to be a contra-party on the non-option leg(s) of the order must take steps immediately to transmit the non-option leg(s) to a non-Exchange market(s) for execution. Failure to observe these requirements will be considered conduct inconsistent with just and equitable principles of trade and a violation of Rule 400.