

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49827; File No. SR-ISE-2004-21)

June 8, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the International Securities Exchange, Inc. to Extend a Pilot Program under Which it Lists Options on Selected Stocks Trading Below \$20 at One-Point Intervals until August 5, 2004

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 4, 2004, the International Securities Exchange, Inc. (“ISE” or “Exchange”) 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 ISE. 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

ISE proposes to extend its pilot program under which it lists options on selected stocks trading below \$20 at \$1 strike price intervals (“\$1 Pilot Program”) until August 5, 2004. The text of the proposed rule change is available at the Office of the Secretary, ISE, and the Commission.

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

In its filing with the Commission, ISE 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

ISE 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

On June 16, 2003, the Commission approved the ISE's \$1 Strike Pilot Program enabling it to list series with \$1 strike price intervals on equity option classes that overlie up to five individual stocks, provided that the strike prices are \$20 or less, but not less than \$3.³ Although ISE may select only up to five individual stocks to be included in the Pilot Program, ISE is also permitted to list options on other individual stocks at \$1 strike price intervals if other options exchanges listed those series pursuant to their respective rules. ISE selected the following five options classes to participate in the Pilot Program: AMR Corp. [AMR], Calpine Corp. [CPN], EMC Corp. [EMC], El Paso Corp. [EP], and Sun Microsystems Inc. [SUNW]. The Pilot Program is set to expire on June 5, 2004.

The Pilot Program Approval Order requires ISE to provide the Commission with certain information and data covering the entire time the Pilot Program was in effect in the event ISE proposes to, among other things, extend the \$1 Pilot Program beyond June 5, 2004.⁴ ISE has conducted a study into the impact that \$1 strikes has made on the participating \$1 Pilot Program classes ("Pilot Program Report") with provides certain data and written analysis relating to the

³ See Securities Exchange Act Release No. 48033 (June 13, 2003), 68 FR 37036 (June 20, 2004)("Pilot Program Approval Order").

⁴ ISE attached the Pilot Program Report as an exhibit to this proposed rule change. Copies of the Pilot Program Report are available at ISE and the Commission's Public Reference Room.

five options classes the exchange selected to participate in the \$1 Pilot Program. Generally, this data shows that there is meaningful trading volume and open interest in the \$1 strikes, as compared to the non-\$1 strikes in the same class. For example, an analysis of the trading in AMR options for the November 2003 series with the April 2004 series indicates that there is a growing interest by investors in the \$1 Pilot Program. In AMR, for the November 2003 series, the collective open interest and trading volume among the \$1 strikes (e.g., \$6, \$9, \$11 and \$14) was 48,122 contracts and 8,872 contracts, respectively, compared to the collective open interest and trading volume among the non-\$1 strikes (e.g., \$7.50, \$10, \$12.50 and \$15) of 134,221 contracts and 23,259 contracts, respectively. For the April 2004 series, the collective open interest and trading volume among the \$1 strikes, (e.g., \$11, \$12, \$13 and \$14) was 36,882 contracts and 45,415 contracts, respectively, compared to the collective open interest and trading volume among the non-\$1 strikes, (e.g., \$10 and \$15) of 49,145 contracts and 9,860 contracts, respectively.

A similar analysis of the trading in CPN options for the October 2003 series with the March 2004 series further lends support for extending the \$1 Pilot Program. For example, in CPN, for the October 2003 series, the collective open interest and trading volume among the \$1 strikes (e.g., \$4, \$6 and \$9) was 22,855 contracts and 3,397 contracts, respectively, compared to the collective open interest and trading volume among the non-\$1 strikes (e.g., \$5, \$7.50 and \$10) of 69,983 contracts and 13,686 contracts, respectively. For the March 2004 series, the collective open interest and trading volume among the \$1 strikes (e.g., \$4, \$6 and \$7) was 54,853 contracts and 16,153 contracts, respectively, compared to the collective open interest and trading volume among the non-\$1 strikes (e.g., \$5) of 16,441 contracts and 13,848 contracts,

respectively. An analysis of the trading in the options for EMC, EP and SUNW revealed similar findings.

While the trading volume and open interest in the \$1 strikes is not always as high as it is the non-\$1 strikes, ISE believes that this can at least partially be attributed to the industry convention of \$2.50 strikes in low priced stocks, and that, over time, this convention will break down and result in a more even distribution in volume and open interest in \$1 strikes. ISE believes that this information and data demonstrates that the five classes it selected to participate were appropriate for the \$1 Pilot Program. The underlying stocks are highly capitalized with low stock prices and generally in different industries, yet the \$1 strike data appears relatively consistent across all five stocks. Moreover, ISE did not experience any capacity issues related to the \$1 Pilot Program, nor does it believe there has been any negative impact on OPRA's capacity as a result of the \$1 Pilot Program. In general, ISE states the \$1 Pilot Program was well received by its Members, and ISE did not receive any complaints from Members or investors regarding the listing of \$1 strikes.

ISE believes that this information and data shows that there is sufficient investor interest and demand to justify extending the \$1 Pilot Program until August 5, 2004. ISE continues to believe that the \$1 Pilot Program has provided investors with greater trading opportunities and flexibility. ISE further believes the \$1 Pilot Program has provided investors with the ability to more closely tailor their investment strategies and decisions to the movement of the underlying security. ISE has not detected any material proliferation of illiquid options series resulting from the narrower strike price intervals.

2. Statutory Basis

ISE believes the proposed rule change is consistent with the Act and the rules and regulations thereunder and, in particular, the requirements of section 6(b) of the Act.⁵ Specifically, ISE believes the proposed rule change is consistent with requirements under Section 6(b)(5) of the Act⁶ that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, 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. ISE believes that extension of the \$1 Pilot Program until August 5, 2004 will result in a continuing benefit to investors, by allowing them to more closely tailor their investment decisions, and will allow ISE to further study investor interest in \$1 strike price intervals.

B. Self-Regulatory Organization's Statement on Burden on Competition

ISE does not believe that the proposed rule change will impose any burden on competition 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 ISE has not solicited, and does not intend to solicit, comments on this proposed rule change. The ISE has not received any unsolicited written comments from its members of other interested persons.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).

Act⁷ and subparagraph (f)(6) of Rule 19b-4⁸ thereunder because it does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate; and ISE has given the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

Under Rule 19b-4(f)(6)(iii) of the Act,⁹ the proposal does not become operative for 30 days after the date of its filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest and ISE is required to give the Commission written notice of its intention to file the proposed rule change at least five business days prior to filing. ISE has requested that the Commission waive 30-day operative delay so that the \$1 Pilot Program may continue without interruption after it would have otherwise expired on June 5, 2004. For this reason, the Commission, consistent with the protection of investors and the public interest, has determined to waive the 30-day operative delay,¹⁰ and, therefore, the

⁷ 15 U.S.C. 78s(b)(3)(A).

⁸ 17 CFR 240.19b-4(f)(6).

⁹ 17 CFR 240.19b-4(f)(6)(iii).

¹⁰ For purposes only of waiving the 30-day operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

proposal is effective and operative upon filing with the Commission.¹¹

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. Please include File Number SR-ISE-2004-21 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-ISE-2004-21. 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies

¹¹ In its Pilot Program Approval Order, the Commission stated that if ISE proposed to (1) extend the \$1 Pilot Program beyond June 5, 2004; (2) expand the number of options eligible for inclusion in the \$1 Pilot Program; or (3) seek permanent approval of the \$1 Pilot Program, the ISE would be required to submit a Pilot Program Report to the Commission along with the filing of such proposal. The Pilot Program Approval Order required the ISE to submit a proposed rule change with the Pilot Program Report at least 60 days prior to the expiration of the \$1 Pilot Program. Because ISE failed to provide its Pilot Program Report to the Commission with sufficient time for the Commission staff to review the report, the Commission is extending the ISE's \$1 Pilot Program only until August 5, 2004, to provide the Commission staff with time to review the ISE's Pilot Program Report.

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 inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of ISE. 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-2004-21 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).