

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50433; File No. SR-ISE-2004-18)

September 23, 2004

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving Proposed Rule Change and Amendments No. 1 and 2 Thereto to Amend the Market Maker Information Barrier Requirements under ISE Rule 810

On May 26, 2004, the International Securities Exchange, Inc. (“ISE”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend ISE Rule 810 by replacing the term “Chinese Wall” with the term, “Information Barrier;” and eliminating the requirement that a market maker maintain an Information Barrier in the limited circumstances where the sole extent to which such market maker or affiliated broker-dealer handles listed options orders as agent on behalf of Public Customers³ or broker-dealers consists of handling such orders pursuant to an exchange sponsored Directed Order Program. The proposal would also exempt a market maker from the Information Barrier requirements of ISE Rule 810 to the extent that the market maker or affiliated broker-dealer engages solely in proprietary trading and does not, under any circumstances, maintain customer accounts or solicit orders or funds from or on behalf of Public Customers or broker-dealers. The ISE also proposed a non-substantive clarification and certain non-substantive technical changes to ISE Rule 810(a).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ ISE Rule 100(a)(32) defines “Public Customer” as “a person that is not a broker-dealer in securities.” ISE Rule 100(a)(33) defines “Public Customer Order” as “an order for the account of a Public Customer.”

The ISE amended the proposal on August 6, 2004⁴ and August 13, 2004.⁵ The proposed rule change, as amended, was published for comment in the Federal Register on August 20, 2004.⁶ The Commission received no comments on the proposed rule change, as amended. This order approves the proposed rule change, as amended.

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.⁷ In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁸ which requires, among other things, that the ISE's rules be designed 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. Specifically, the Commission believes that the ISE's proposal to provide two additional exceptions from the Information Barrier requirements of ISE Rule 810 is consistent with the Act.

One exception would eliminate the requirement that a market maker maintain an Information Barrier in the limited circumstances where a market maker or affiliated broker-

⁴ On August 6, 2004, the ISE filed a Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1").

⁵ On August 13, 2004, the ISE filed a Form 19b-4, which replaced the original filing and Amendment No. 1 in their entirety ("Amendment No. 2").

⁶ See Securities Exchange Act Release No. 50197 (August 13, 2004), 69 FR 51735.

⁷ In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(5).

dealer engages solely in proprietary trading.⁹ The Commission believes it is reasonable to remove this requirement, since the market maker, or its affiliated broker-dealer, is not engaged in activities that would inappropriately benefit other business activities within the firm. However, the Commission notes that if in the future these market makers, or their affiliated broker-dealers, engage in other business activities, such as investment banking or market making in the stocks underlying the options in which it makes markets, or maintain customer accounts, or solicit or accept Public Customer orders, the Commission expects that the ISE will require compliance with the Information Barrier requirements of ISE Rule 810.

The second exception from ISE Rule 810 would not require an Information Barrier between an ISE Member's ISE market making operations and options market making operations on other exchanges where that Member handles orders as agent only for the accounts of affiliated entities or solely in an eligible Directed Order Program. Eligible Directed Order Programs must contain rules designed to ensure that market makers do not gain an advantage in handling Directed Orders because the information they possess may be used inappropriately for the benefit of the market maker receiving the Directed Order. For example, a market maker that chooses to accept Directed Orders must accept all orders directed to it, may not accept orders directly, other than through an exchange system, and the market maker may not handle such orders on a disclosed or discretionary basis. Therefore, the Commission believes that it is reasonable to not require an Information Barrier in such cases, since the rules of such Directed Order Programs should provide safeguards that should limit the misuse of information with regard to the terms of orders that affiliates of ISE members are handling as agent.

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The Commission notes that this section of the proposal is similar to Pacific Exchange, Inc. Rule 7.26. See Securities Exchange Act Release No. 49264 (February 17, 2004), 69 FR 8510 (February 24, 2004)(SR-PCX-2003-49).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-ISE-2004-18), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland
Deputy Secretary

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).