

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51111; File No. SR-ISE-2005-08)

January 31, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto Relating to Limitations on End-of-Day Trade-Through Liability

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 January 26, 2005, 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 the ISE. On January 28, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Exchange has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act,⁴ and Rule 19b-4(f)(6) thereunder,⁵ which renders the proposal effective upon filing with the Commission.⁶ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Partial Amendment dated January 28, 2005 (“Amendment No. 1”). In Amendment No. 1, the Exchange corrected a typographical error in the rule text included in the original rule filing.

⁴ 15 U.S.C. 78s(b)(3)(A).

⁵ 17 CFR 240.19b-4(f)(6).

⁶ The ISE asked the Commission to waive the 30-day operative delay. See Rule 19b-4(f)(6)(iii). 17 CFR 240.19b-4(f)(6)(iii).

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The ISE is proposing two changes to the current limitations on trade-through liability at the end of the trading day. First, the limit on liability is being raised to 50 contracts as of February 1, 2005. Second, this limit will be a pilot program, which expires on January 31, 2006. The text of the proposed rule change is available on the ISE's Web site (www.iseoptions.com), at the ISE's Office of the Secretary, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the 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. The Exchange 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

The purpose of the proposed rule change is to amend the limitation on end-of-day trade-through liability. By way of background, the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan") requires participating exchanges ("Participants") to impose liability on their members who trade at prices inferior to those displayed on competing exchanges. Among other things, in the event that a member "trades through" a customer limit order on another market, the exchange that is traded through can send a "Satisfaction Order,"

requiring the member to fill a Linkage order sent on behalf of the aggrieved customer.⁷

Generally, the member is liable for the entire size of the customer order (up to the size of the trade-through). However, because it may be difficult for a member to hedge a position it acquires at the end of the day when filling a Satisfaction Order, all Participants currently limit this liability to 25 contracts during the last seven minutes of options trading.

The 25-contract limit is a pilot program that is scheduled to expire on January 31, 2005. The ISE is proposing to extend the exemption through January 31, 2006 and to raise the limit on liability to 50 contracts. The Participants currently are considering Linkage Plan amendments that, if proposed and approved, could obviate the need for this limitation of liability. Specifically, the amendments would increase the ability for members of Participants to receive automatic execution of P/A Orders and would provide tools to avoid trade-through liability generally, including at the end of the day. The Exchange anticipates that these amendments could be in effect within a year. At that time, the Participants would either allow the pilot to lapse, or, if they believed that a continuation of the limitation was appropriate, would discuss the matter further with the Commission staff.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,⁸ which requires that an exchange have rules that are designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. In particular, the proposed rule change

⁷ See Section 2(16)(c) of the Linkage Plan.

⁸ 15 U.S.C. 78f(b)(5).

would implement a provision of the Linkage Plan, providing a common limitation on liability for all participants in the options market.

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

The Exchange 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 Exchange has neither solicited nor received comments on the proposed rule change.

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

Because the foregoing rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act⁹ and Rule 19b-4(f)(6) thereunder.¹⁰

A proposed rule change filed under Rule 19b-4(f)(6)¹¹ normally does not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the five-day pre-filing requirement and the 30-day operative delay, as specified in Rule 19b-4(f)(6)(iii), and designate the proposed rule change immediately operative.

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6).

¹¹ 17 CFR 240.19b-4(f)(6).

The Commission believes that waiving the five-day pre-filing provision and the 30-day operative delay is consistent with the protection of investors and the public interest.¹² By waiving the pre-filing requirement and accelerating the operative date, the Pilot Program can continue without interruption. The Commission believes that allowing the pilot to continue will allow Participants to either gather sufficient information to justify the need for the pilot program or determine that the exemption from trade-through liability is no longer necessary. Increasing the maximum number of contracts to be satisfied with respect to Satisfaction Orders in the last seven minutes of trading in options to 50 contracts will enhance customer order protection.

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.¹³

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

¹² For purposes of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change under Section 19(b)(3)(C) of the Act, the Commission considers the period to commence on January 28, 2005, the date the Exchange filed Amendment No. 1 to the proposed rule change. See 15 U.S.C. 78s(c)(3)(C).

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-ISE-2005-08 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-2005-08. 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 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. Copies of the filing also will be available for inspection and copying at the principal office of the 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 SR-ISE-2005-08 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.¹⁴

Margaret H. McFarland
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).