

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51443; File No. SR-ISE-2004-40)

March 29, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the International Securities Exchange, Inc. Relating to Procedures for the Allocation of Market Maker Appointments

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 December 14, 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, II, and III below, which Items have been prepared by the ISE. On January 18, 2005, the ISE filed Amendment No. 1 to the proposed rule change.³ On March 2, 2005, the ISE filed Amendment No. 2 to the proposed rule change.⁴ On March 21, 2005, the ISE filed Amendment No. 3 to the proposed rule change.⁵ 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 Form 19b-4, dated January 18, 2005, which replaced the original filing in its entirety (“Amendment No. 1”).

⁴ See Form 19b-4, dated March 2, 2005, which replaced Amendment No. 1 in its entirety (“Amendment No. 2”).

⁵ See Form 19b-4, dated March 21, 2005, which replaced Amendment No. 2 in its entirety (“Amendment No. 3”). Collectively, Amendment Nos. 1, 2, and 3 clarified the following: (1) that ISE’s Board or designated committee shall make appointments in the best interest of the exchange to provide competitive markets; (2) that changes to the allocation requirements for index options will be prospective only; and (3) that information regarding order flow arrangements will not be used as a basis for remedial action.

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

The Exchange proposes to amend ISE Rule 802 to (1) specify that allocations of market maker appointments must be made in the best interest of the Exchange and (2) add criteria specific to the allocation of market maker appointments in index options in addition to the criteria currently contained in the Rule.

The text of the proposed rule change is available on the ISE’s website (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 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

When the Exchange lists new options classes, it allocates them to one of its Primary Market Makers under ISE Rule 802. Pursuant to power delegated by the Exchange’s Board, an Allocation Committee, which consists of representatives of Electronic Access Members, makes allocation decisions according to the guidelines contained in ISE Rule 802. ISE Rule 802 states, among other things, that the Allocation Committee should consider the following in making its

decisions: the financial resources available to the Primary Market Maker, the Primary Market Maker's experience and expertise in market making or options trading, and the maintenance and enhancement of competition among Primary Market Makers.

The Exchange believes that, as competition among the options exchanges continues to intensify, it is increasingly important for the Exchange to assure that products are allocated to the Primary Market Makers that make the best markets. While it is implied that the Exchange's Board and all Exchange committees always must act in the best interest of the Exchange to provide competitive markets, because allocation decisions have a direct impact on the competitiveness of the Exchange, the Exchange proposes to specify this obligation to act in the best interest of the Exchange in ISE Rule 802.

According to the Exchange, options on index-based products can be among the most actively traded listed options, making them among the most important products to the Exchange. While the Exchange believes that the allocation standards contained in ISE Rule 802 work reasonably well with respect to the allocation of equity options, the Exchange believes it is appropriate for the Exchange to seek more specific commitments from Primary Market Makers as to the quality of the markets they are prepared to make in certain index-based products (i.e., options on indices and exchange-traded funds). Moreover, the Exchange believes it is appropriate to have the ability to base re-allocation decisions on the failure of a Primary Market Maker to comply with its market quality commitments. The proposed rule change would not apply to allocation decisions made prior to approval of this proposed rule change by the Commission.

The Exchange proposes to supplement the current allocation criteria to require Primary Market Makers who ask for an allocation of an index-based product to provide specific quarterly

spread and size commitments for the first year of listing. The Allocation Committee would consider these commitments in making its allocation decisions in addition to the factors currently contained in ISE Rule 802. A Primary Market Maker also may, but would not be required to, provide commitments regarding marketing or other support (including order flow commitments), with respect to the index-based product.

Under the proposal, the Primary Market Maker's size and spread quotation commitments for the fourth quarter following the listing of the index-based product would remain in effect thereafter on a quarter-to-quarter basis unless a change in such commitment is approved upon the request of the Primary Market Maker. Any other commitments that a Primary Market Maker makes also would remain in effect until modified by the Board or designated committee upon the Primary Market Maker's request. In addition, a failure of a Primary Market Maker to meet its commitments would enable (but not require) the Allocation Committee to terminate an allocation and reallocate the product to another Primary Market Maker.

The proposal also would allow, but would not require, a Primary Market Maker to provide information regarding order flow arrangements with order flow providers. The Allocation Committee would use any information provided by a Primary Market Maker regarding the existence of order flow arrangements solely to evaluate existing order flow arrangements between the applicant and order flow providers. A future change to, or termination of, any such arrangements considered by the Allocation Committee during the review process would not be used by the Committee at any point in the future to terminate an allocation or take remedial action against a Primary Market Maker. Furthermore, the Allocation Committee would not take any remedial action solely because orders subject to any such arrangements were not subsequently routed to the Exchange. Whether actual arrangements result in orders being routed

to the Exchange would be considered by the Exchange as a separate matter from the criteria for which a Primary Market Maker's performance would be evaluated.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b) of the Act,⁶ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁷ in particular, because it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and national market system, and, in general, to protect investors and the public interest. In particular, the Exchange believes that the proposed rule change, as amended, would help assure that the Exchange allocates index-based products to Primary Market Makers that are committed to making competitive markets, which the Exchange believes would benefit investors and the Exchange.

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

The Exchange believes that the proposed rule change, as amended, does not impose any burden on competition that is 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 not solicited, and does not intend to solicit, comments on this proposed rule change, as amended. The Exchange has not received any unsolicited written comments from its members or other interested parties.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2004-40 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-2004-40. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such 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 Number SR-ISE-2004-40 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.⁸

Margaret H. McFarland
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).