SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52331; File No. SR-ISE-2004-16)

August 24, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendment No. 1 Thereto Establishing a Directed Order Process

On May 20, 2004, the International Securities Exchange, Inc. ("ISE" or "Exchange") 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 adopt new ISE Rule 811 to allow Exchange market makers to receive Public Customer Orders directed to them from Electronic Access Members ("EAMs") through the Exchange's system ("Directed Orders"). On April 26, 2005, the ISE filed Amendment No.1 to the proposed rule change.[3] The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on June 20, 2005.[4] The Commission received no comments on the proposed rule change.

Under ISE's proposal, a market maker that wishes to accept Directed Orders must systemically indicate that it wishes to receive Directed Orders each day, must be willing to accept Directed Orders from all EAMs, may receive Directed Orders only through the Exchange's system, and may not reject Directed Orders. A market maker receiving a Directed Order ("Directed Market Maker") would have to, within three seconds of receipt of the order, either submit the Directed Order to the Price Improvement Mechanism ("PIM"), or send the order to the Exchange's limit order book. If the market maker submits the order to the PIM and

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Amendment No. 1 replaced and superseded the original filing in its entirety.

4 Securities Exchange Act Release No. 51835 (June 13, 2005), 70 FR 35479.

is quoting at the national best bid or offer ("NBBO") on the opposite side of the Directed Order, it would be prohibited from changing its quotation to a price less favorable than the price available at the NBBO or reducing the size of its quotation prior to submitting the Directed Order to the PIM, unless such quotation change is the result of an automated quotation system that operates independently from the existence or nonexistence of a pending Directed Order. If the market maker sends the order to the Exchange's limit order book (or the Exchange system releases the order to the limit order book after three seconds) certain restrictions would apply to a market maker's ability to trade with the order depending on whether the Directed Order is marketable or not marketable, and whether the Directed Market Maker is quoting at the NBBO or not quoting at the NBBO. In any case, the Directed Market Maker would be last in priority when the Directed Order is matched against contra interest.

After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange.[5] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[6] which requires among other things, 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 transaction in securities, 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.

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

6 15 U.S.C. 78f(b)(5).

The Commission notes that the proposal is similar to the Directed Order program currently in place on the Boston Options Exchange facility ("BOX") of the Boston Stock Exchange, Inc. ("BSE").[7] Similar to the program currently in place on BOX, market makers receiving Directed Orders must accept all orders directed to them and must send such orders only to the PIM or to the Exchange's limit order book. In addition, a market maker that receives a Directed Order when not quoting at the NBBO as well as when quoting at the NBBO, would have to wait three seconds before trading with the Directed Order. The Directed Order would be exposed to other market participants to give them the first opportunity to trade with the Directed Order. Accordingly, the Commission believes that the proposal would not provide any disincentive for market makers that receive Directed Orders to quote competitively.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[8] that the proposed rule change (SR-ISE-2004-16) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[9]

Margaret H. McFarland
Deputy Secretary

7 See BSE Rules Chapter VI, Section 5(b) and (c), and Section 10.

8 15 U.S.C. 78s(b)(2).

9 17 CFR 200.30-3(a)(12).