SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52347; File No. SR-ISE-2005-23)

August 26, 2005

Self-Regulatory Organizations; International Stock Exchange, Inc.; Order Approving Proposed Rule Change Establishing a De Minimis Exception to the 80/20 Test

I. Introduction

On May 13, 2005, the International Stock 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 seeking to amend ISE Rule 1904 to establish a de minimis exception to the 80/20 Test limiting market makers' use of Principal Orders[3] under the rules imposed by the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Linkage Plan")[4] and related rules.

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

2 17 CFR 240.19b-4.

3 The Exchange defines a Principal Order as an order for the principal account of a market maker (or equivalent entity on another Participant Exchange) and which is not a Principal Acting as Agent Order. See Chapter 19, Rule 1900(10)(ii) of the ISE Rules.

4 On July 28, 2000, the Commission approved a national market system plan for the purpose of creating and operating an intermarket options market linkage ("Linkage") proposed by the American Stock Exchange, LLC, Chicago Board Options Exchange, Inc., and the ISE. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000). Subsequently, the Philadelphia Stock Exchange, Inc., the Pacific Exchange, Inc. and the Boston Stock Exchange, Inc. joined the Linkage Plan. See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000); 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000); and 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004).

The proposed rule change was noticed for comment in the Federal Register on July 26, 2005.[5] The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description

The purpose of this proposed rule change is to implement proposed Joint Amendment No. 17 to the Linkage Plan. Joint Amendment No. 17, together with this proposed rule change, would establish a de minimis exception to the "80/20 Test" set forth in Section 8(b)(iii) of the Linkage Plan and ISE Rule 1904.

Section 8(b)(iii) of the Linkage Plan permits market makers to access away markets on a limited basis for their own principal trading. The Linkage Plan enforces this limitation via the 80/20 Test, which generally requires at least 80 percent of a market maker's trading volume in an option class to be on its own exchange for the market maker to be able to use Linkage to send Principal Orders for its own account in that class. If a market maker "fails" the 80/20 Test in an option class during a calendar quarter, it cannot send Principal Orders through Linkage in that class during the next calendar quarter.

The options exchanges have agreed to adopt a de minimis exception to the 80/20 Test. As proposed by the Exchange, the 80/20 Test would not apply to any market maker that has total volume of less than 1,000 contracts in an option during a calendar quarter. At this low volume, even a small number of Principal Orders could result in the market maker being disqualified from Linkage in that class for a calendar quarter. The Exchange believes that this proposed exception would address such concerns.

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5 See Securities Exchange Act Release No. 52069 (July 20, 2005), 70 FR 43203 (July 26, 2005).

III. Discussion

After careful review, 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.[6] In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act[7] which requires, among other things, that the rules of an exchange 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 to protect investors and the public interest. The Commission believes that the proposed rule change will increase the availability of Linkage to members of the Participants by limiting the applicability of the 80/20 Test in situations where market makers have minimal trading volume in a particular options class.

The Commission recognizes that the Exchange does not believe that it is necessary to bar market makers with limited volume from sending Principal Orders through the Linkage, as such trading does not raise concerns that a member is sending such orders as "a primary aspect of their business." The Commission believes that the de minimis exemption from the 80/20 Test proposed by the Exchange for market makers that have a total contract volume of less than 1,000 contracts in an options class for a calendar quarter should ensure that members with relatively low volume in a particular options class can send a reasonable number of Principal Orders without being barred from using the Linkage by application of the 80/20 Test in the following calendar quarter.

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

7 15 U.S.C. 78f(b)(5).

IV. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[8] that the proposed rule change (SR-ISE-2005-23) is approved.

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

Margaret H. McFarland
Deputy Secretary

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

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