SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57254; File No. SR-ISE-2006-26)

February 1, 2008

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Relating to Professional Account Holders

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 May 5, 2006, the International Securities Exchange, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change as described in Items I, II, and III below, which Items have been prepared substantially by the ISE. On January 25, 2008, the Exchange filed Amendment No. 1 to the proposal.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons.

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

The ISE is proposing to amend ISE Rules 713 (Priority of Quotes and Orders), 716 (Block Trades) and 723 (Price Improvement Mechanism for Crossing Transactions) to give certain non-broker-dealer orders the same priority as broker-dealer orders and market maker quotes. The ISE also proposes to charge the same fee for the execution of certain non-broker-dealer orders as is applicable to the execution of broker-dealer orders on the Exchange. The text of the proposed rule change is available on the Exchange's Web site

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

2 17 CFR 240.19b-4.

3 Amendment No. 1 replaced the previously filed proposed rule change in its entirety.

(http://www.iseoptions.com), at the principal office of the Exchange, 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

Under ISE rules, a "Public Customer" is any person or entity that is not a broker or dealer in securities, and a "Public Customer Order" is an order for the account of a Public Customer.[4] A "Non-Customer" is any person or entity that is a broker or dealer in securities, and a "Non-Customer Order" is an order for the account of a broker or dealer.[5] These terms are used in ISE specific rules that provide certain marketplace advantages to Public Customer Orders over Non-Customer Orders. In particular, under ISE rules (i) Public Customer Orders are given priority over Non-Customer Orders and market maker quotes at the same price,[6] and (ii) subject to certain exceptions, members are not charged a transaction fee for the execution of Public Customer Orders. The purpose of providing these marketplace advantages to Public Customer

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4 ISE Rule 100(a)(32) and (33).

5 ISE Rule 100(a)(22) and (23).

6 ISE Rules 713 (Priority of Quotes and Orders), 716 (Block Trades) and 723 (Price Improvement Mechanism for Crossing Transactions).

Orders is to attract retail investor order flow to the Exchange by leveling the playing field for retail investors over market professionals[7] and providing competitive pricing.

With respect to these ISE marketplace advantages, the Exchange does not believe the definitions of Public Customer and Non-Customer properly distinguish between non-professional retail investors and certain professionals. According to the Exchange, providing marketplace advantages based upon whether the order is for the account of a participant that is a registered broker-dealer is no longer appropriate in today's marketplace because some non-broker-dealer individuals and entities have access to information and technology that enables them to professionally trade listed options in the same manner as a broker or dealer in securities.[8] These individual traders and entities (collectively, "professional account holders") have the same technological and informational advantages over retail investors as broker-dealers trading for their own account, which enables them to compete effectively with broker-dealer orders and market maker quotes for execution opportunities in the ISE marketplace.[9]

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7 Market professionals have access to sophisticated trading systems that contain functionality not available to a retail customer, including things such as continuously updated pricing models based upon real-time streaming data, access to multiple markets simultaneously, and order and risk management tools.

8 Exchange staff visited a broker-dealer that provided their professional customers with multi-screened trading stations equipped with trading technology that allowed the trader to monitor and place orders on all six options exchanges simultaneously. These trading stations also provided compliance filters, order management tools, the ability to place orders in the underlying securities, and market data feeds.

9 Market makers enter quotes based upon the theoretical value of the option, which moves with various factors in their pricing models, such as the value of the underlying security. Professional customers place and cancel orders in relation to an options theoretical value in much the same manner as a market maker. This is evidenced by the entry of limit orders that join the best bid or offer and by a very high rate of orders that are canceled. In contrast, retail customers who enter orders as part of an investment strategy (such as a covered right or a directional trade) most frequently enter marketable orders or limit orders that they do not cancel and replace. A study of 10 retail-oriented broker-dealer members over a six-month period indicated that typically only around 20% of their executed customer volume resulted from orders that joined the ISE best bid or offer upon

The Exchange therefore does not believe that it is consistent with fair competition for these professional accounts holders to continue to receive the same marketplace advantages as retail investors over broker-dealers trading on the ISE. Moreover, because Public Customer Orders at the same price are executed in time priority, retail investors are prevented from fully benefiting from the priority advantage when professional account holders are afforded Public Customer Order priority.

Accordingly, the Exchange is seeking to adopt two new terms that will be used to more appropriately provide ISE marketplace advantages to retail investors on the ISE. Under the proposal, execution priority under ISE Rules 713 (Priority of Quotes and Orders), 716 (Block Trades) and 723 (Price Improvement Mechanism for Crossing Transactions) will be given to "Priority Customer Orders" over "Professional Orders" and market maker quotes. Transaction fees will also be charged using these definitions. Specifically, the ISE will charge standard transaction fees currently applicable to broker-dealer orders for Professional Orders, and fee waivers currently available to Public Customer Orders will be limited to Priority Customer Orders. A Priority Customer Order will be defined as a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). A "Professional Order" will be defined as an order that is for the account of a person or entity that is not a Priority Customer.

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entry. In contrast, over the same period, around 45% of the volume executed by a broker-dealer with a professional trader client base resulted from orders that joined the ISE best bid and offer upon entry. Additionally, retail-oriented broker-dealer members generally have a cancel to trade ratio that is less than 1 (i.e., more of their orders are executed than canceled), whereas members with a professional trader client base generally have cancel to trade ratios that exceed 5 (i.e., for every order that is executed, 5 are canceled).

The use of these new terms in the execution rules and fee schedule will result in professional account holders participating in the ISE's allocation process on equal terms with broker-dealer orders and market maker quotes. It will also result in members paying the same transaction fees for the execution of orders for a professional account as they do for broker-dealer orders. The proposal will not otherwise affect non-broker-dealer individuals or entities under the ISE rules, and in particular, all Public Customer Orders will continue to be treated equally for purposes of the linkage-related rules. For example, the ISE will provide the same away-market protection for all Public Customer Orders, including non-broker-dealer orders that are included in the definition of "Professional Orders."[10]

In order to properly represent orders entered on the Exchange according to the new definitions, Electronic Access Members will be required to indicate whether Public Customer Orders are "Priority Customer Orders" or "Professional Orders." To comply with this requirement, Electronic Access Members will be required to review their customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker or dealer should be represented as Priority Customer Orders or Professional Orders.

The Exchange believes that identifying professional account holders based upon the average number of orders entered for a beneficial account is an appropriately objective approach that will reasonably distinguish such persons and entities from retail investors. The Exchange

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[10] Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional Orders for the next calendar quarter. Members will be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five days after the end of each calendar quarter. While Members only will be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as Priority Customer Orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the Member and the Member will be required to change the manner in which it is representing the customer's orders within five days.

proposes the threshold of 390 orders per day on average over a calendar month because it believes it far exceeds the number of orders that are entered by retail investors in a single day,[11] while being a sufficiently low number of orders to cover the professional account holders that are competing with broker-dealers in the ISE marketplace. In addition, basing the standard on the number of orders that are entered in listed options for a beneficial account(s) assures that professional account holders cannot inappropriately avoid the purpose of the rule by spreading their trading activity over multiple exchanges, and using an average number over a calendar month will prevent gaming of the 390 order threshold.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)[12] that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, 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. In particular, the proposal will assure that retail investors continue to receive the appropriate marketplace and cost advantages in the ISE

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[11] Three hundred and ninety orders is equal to the total number of orders that a person would place in a day if that person entered one order every minute from market open to market close. A study of one of the largest retail-oriented options brokerage firms indicated that on a typical trading day, options orders were entered with respect to 5922 different customer accounts. There was only one order entered with respect to 3765 of the 5922 different customer accounts on this day, and there were only 17 customer accounts with respect to which more than 10 orders were entered. The highest number of orders entered with respect to any one account over the course of an entire week was 27. Additionally, many of the largest retail-oriented electronic brokers offer lower commission rates to customers they define as "active traders." The Exchange reviewed the publicly available information from the web sites for Charles Schwab, Fidelity, TD Ameritrade and optionsXpress, all of which define an "active trader" as someone who executes only a few options trades per month. The highest required trading activity to qualify as an active trader among these four firms was 35 trades per quarter.

[12] 15 U.S.C. 78f(b)(5).

marketplace, while furthering fair competition among marketplace professionals by treating them equally within the ISE marketplace.

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

The proposed rule change 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. The Exchange has not received any written comments from members or other interested parties.

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 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-2006-26 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ISE-2006-26. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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 Number SR-ISE-2006-26 and should be submitted on or before [insert date 21 days after publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[13]

Florence E. Harmon
Deputy Secretary

[13] 17 CFR 200.30-3(a)(12).