

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52364; File No. SR-ISE-2005-41)

August 31, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Price Improvement Mechanism

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 August 22, 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. The Exchange filed the proposed rule change as a “non-controversial” rule change under Rule 19b-4(f)(6) under the Act,³ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to add an order type called the Customer Participation Order, which can be used by public customers to participate in the Price Improvement Mechanism (“PIM”). Proposed new language is italicized; proposed deletions are in [brackets].

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Rule 715.

(a) through (e) no change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

(f) Customer Participation Orders. A Customer Participation Order (“CPO”) is a limit order on behalf of a Public Customer that, in addition to the limit order price in standard increments according to Rule 710, includes a price stated in one-cent increments (the “Participation Interest”) at which the Public Customer wishes to participate in trades executed in the same options series in penny increments through the Price Improvement Mechanism pursuant to Rule 723. The Participation Interest price must be higher than the limit order price in the case of a CPO to buy, and lower than the limit order price in the case of a CPO to sell. The size of the order will be automatically decremented when the Public Customer participates in the execution of an order at the Participation Interest price.

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Rule 723. Price Improvement Mechanism for Crossing Transactions

(a) through (c) no change.

(d). Execution . At the end of the exposure period the Agency Order will be executed in full at the best prices available, taking into consideration orders and quotes in the Exchange’s market, Improvement Orders, Customer Participation Orders (see Supplementary Material .06 below) and the Counter-Side Order. The Agency Order will receive executions at multiple price levels if there is insufficient size to execute the entire order at the best price.

(d)(1) through (d)(6) no change.

Supplementary Material to Rule 723

.01 through .05 no change.

.06. Pursuant to Rule 723(c)(2), Electronic Access Members may enter Improvement Orders for the account of Public Customers. Without limiting the forgoing, Electronic Access Members may enter Improvement Orders with respect to CPOs (as defined in Rule 715(f)). An

Improvement Order can be entered with respect to a CPO if: (1) the limit order price of the CPO is equal to the best bid or offer on the Exchange at the time the PIM is initiated; and (2) the CPO is on the same side of the market as the Counter-Side Order. The Improvement Order must be entered for the existing size of the limit order up to the size of the Agency Order and for the price of the Participation Interest.

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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, Proposed Rule Change

1. Purpose

The PIM is a process by which crossing transactions may be exposed to the market for price improvement. Under ISE Rule 723, upon the entry of a Crossing Transaction, a broadcast message is sent to all Members, which then have three seconds to enter Improvement Orders that indicate the size and price at which they want to participate in the execution. Improvement Orders may be entered by all Members for their own account or for the account of a Public Customer in one-cent increments. ISE Rule 723 does not limit the circumstances in which Electronic Access Members may enter Improvement Orders on behalf of Public Customers.

The Exchange proposes to implement an additional order type that will facilitate the ability of Members to participate in trades in penny increments through the PIM, and to amend ISE Rule 723 to specify that Members may enter Improvement Orders on behalf of Public Customers that utilize the new order type. This additional functionality is purely voluntary, and merely supplements the open access currently provided in ISE Rule 723. The Exchange believes that some Members may wish to provide PIM access to Public Customers in this particular manner.⁴

The Exchange proposes to define a Customer Participation Order (“CPO”) in ISE Rule 715 as a limit order on behalf of a Public Customer that, in addition to the limit order price in standard trading increments, includes a price stated in one-cent increments (the “Participation Interest”) at which the Public Customer wishes to participate in trades in the same options series in penny increments through the PIM. The Participation Interest price must be higher than the limit order price in the case of a CPO to buy, and lower than the limit order price in the case of a CPO to sell. The Exchange also proposes to amend ISE Rule 723 to specify that an Electronic Access Member may enter an Improvement Order with respect to a CPO if: (1) the limit order price is equal to the best bid or offer on the Exchange at the time the PIM is initiated; and (2) the CPO is on the same side of the market as the Counter-Side Order.

The CPO is an instruction to the member to enter an Improvement Order on behalf of the Public Customer at a particular price and size. The Improvement Order must be entered for the existing size of the limit order up to the size of the Agency Order being executed through the PIM, and for the price of the Participation Interest. The CPO does not give the member

⁴ The Boston Options Exchange facility (“BOX”) of the Boston Stock Exchange, Inc. (“BSE”) provides access to its price improvement process through the use of a similar order type. See Chapter V, Section 18(g) of the BOX Rules.

discretion to enter an Improvement Order at any lesser size or price, nor to modify the price or size of the Improvement Order once it is entered. The size of the CPO will be automatically decremented by the execution of a related Improvement Order.

2. Statutory Basis

According to the ISE, the basis under the Act for this proposed rule change is found in Section 6(b)(5) of the Act,⁵ in that the proposed rule change is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest. The Exchange believes that the additional functionality will increase the ability for Electronic Access Members to participate in the PIM on behalf of Public Customers.

Accordingly, the proposed rule change could result in greater participation in PIM executions by Public Customers and greater opportunity for price improvement for the orders being executed through the PIM.

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

The ISE does not believe that the proposed rule change will impose any inappropriate 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 ISE neither solicited nor received written comments on the proposed rule change.

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

Because the proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and

⁵ 15 U.S.C. 78f(b)(5).

(iii) by its terms, does not become operative for 30 days after the date of filing (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 Act⁶ and subparagraph (f)(6) of Rule 19b-4 thereunder.⁷ As required under Rule 19b-4(f)(6)(iii),⁸ the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of the filing of the proposed rule change.

A proposed rule change filed under Rule 19b-4(f)(6)(iii) normally may not become operative prior to 30 days after the date of filing.⁹ However, Rule 19b-4(f)(6)(iii)¹⁰ 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 30-day operative delay and render the proposed rule change to become operative immediately. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Waiver of the 30-day operative delay would enable the Exchange to implement the proposal as quickly as possible. In addition, the Commission notes that the BSE uses an order type that is substantially similar to the ISE's proposed CPO.¹¹ The Commission does

⁶ 15 U.S.C. 78s(b)(3)(A).

⁷ 17 CFR 240.19b-4(f)(6).

⁸ 17 CFR 240.19b-4(f)(6)(iii).

⁹ Id.

¹⁰ Id.

¹¹ See Chapter V, Section 18(g) of the BOX Rules (describing the Price Improvement Period (“PIP”) and the operation of the BOX Customer PIP Order). See also Securities Exchange Act Release No. 51651 (May 3, 2005), 70 FR 24848 (May 11, 2005) (order approving SR-BSE-2005-01).

not believe that the proposed rule change raises new regulatory issues. For the reasons stated above, the Commission designates the proposal to become operative immediately.¹²

At any time within 60 days of the filing of the 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 the furtherance of the purposes of the Act.

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-2005-41 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-ISE-2005-41. 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

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

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. 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-2005-41 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.¹³

Jonathan G. Katz
Secretary

¹³ 17 CFR 200.30-3(a)(12).