

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49866; File No. SR-ISE-2004-14)

June 15, 2004

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change by the International Securities Exchange, Inc. Relating to Limitations on End-of-Day Trade-Through Liability

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 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 and II below, which Items have been prepared by the ISE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons, and to grant accelerated approval to the proposed rule change.

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

The ISE is proposing two changes to the current limitations on Trade-Through³ liability during the last seven minutes of the trading day pursuant to the Linkage Plan. First, the limit on

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ A “Trade-Through” is defined as a transaction in an options series at a price that is inferior to the national best bid or offer in an options series calculated by a Participant. See Section 2(29) of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Linkage Plan”). A “Participant” is defined as an Eligible Exchange whose participation in the Linkage Plan has become effective pursuant to Section 4(c) of the Linkage Plan. See Section 2(24) of the Linkage Plan. Currently, the Participants in the Linkage Plan are the ISE, the American Stock Exchange LLC, the Chicago Board Options Exchange, Inc., the Pacific Exchange, Inc., the Philadelphia Stock Exchange, Inc. and the Boston Stock Exchange, Inc.

Trade-Through liability would be raised from 10 contracts to 25 contracts per Satisfaction Order as of July 1, 2004. Second, the pilot program that implemented a limitation on liability would be extended to January 31, 2005.

The text of the proposed rule change is available at the Exchange and at the Commission.

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 Exchange 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 III below. The Exchange 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

The purpose of the proposed rule change is to amend ISE Rule 1902 (Order Protection) to correspond to proposed Joint Amendment No. 12 to the Linkage Plan,⁴ which would, among

⁴ The ISE has separately filed Joint Amendment No. 12 to the Linkage Plan to implement substantially the same change to the Linkage Plan. See Securities Exchange Act Release No. 49692 (May 12, 2004), 69 FR 29956 (May 19, 2004) (Notice of Joint Amendment No. 12). The Commission previously approved the pilot to implement a limitation on Trade-Through liability during the last seven minutes of the trading day on a 120-day temporary basis on January 31, 2003. See Securities Exchange Act Release No. 47298, 68 FR 6524 (February 7, 2003). On June 18, 2003, the Commission approved the pilot until January 31, 2004. See Securities Exchange Act Release No. 48055, 68 FR 37869 (June 25, 2003) (Order approving Joint Amendment No. 4). The Commission subsequently extended the pilot until June 30, 2004. See Securities Exchange Act Release No. 49146 (January 29, 2004), 69 FR 5618 (February 5, 2004) (Order approving Joint Amendment No. 8).

other things, amend the limitation on end-of-day Trade Through liability.⁵ By way of background, the Linkage Plan requires Participants to impose liability on their members who trade at prices inferior to those displayed on competing exchanges. Among other things, in the event that a member trades through a customer limit order on another market, the exchange that is traded through can send a Satisfaction Order,⁶ requiring the member to fill the customer limit order. Generally, the member is liable for the entire size of the customer order (up to the size of the Trade-Through). However, because it may be difficult for a member to hedge a position it acquires at the end of the day when filling a Satisfaction Order, the Participants currently limit this liability to 10 contracts per Satisfaction Order for the last seven minutes of options trading.⁷

The 10-contract limit is a temporary pilot program that is scheduled to expire on June 30, 2004.⁸ The Participants are working with the Commission to determine whether to make a limitation on Trade-Through liability during the last seven minutes of the trading day permanent, and the Commission has requested that the Participants provide data justifying the continuation of the exemption. Pending this review of the exemption, along with the other Participants, the

⁵ Telephone conversation among Michael Simon, Senior Vice President and General Counsel, ISE, Timothy Fox, Attorney-Advisor, Division of Market Regulation, Commission and Geraldine Idrizi, Attorney-Advisor, Division, Commission on May 25, 2004.

⁶ A “Satisfaction Order” is defined as an order sent through the Options Intermarket Linkage to notify a member of another Participant of a Trade-Through and to seek satisfaction of the liability arising from that Trade-Through. See Section 2(16) of the Linkage Plan.

⁷ See supra note 4.

⁸ See Order approving Joint Amendment No. 8, supra note 4.

ISE is proposing to extend the exemption through January 31, 2005 and raise the limit on liability from 10 contracts to 25 contracts per Satisfaction Order.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5) of the Act⁹ 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 transactions 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. In particular, the proposed rule change would implement a provision in the Linkage Plan, providing a common limitation on liability for all participants in the options market.

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

The ISE believes that 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 unsolicited written comments from members or other interested parties.

⁹ 15 U.S.C. 78f(b)(5).

III. 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-2004-14 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-2004-14. 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. 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-2004-14 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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.¹⁰ In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act¹¹, which requires, among other things, that the rules of a national securities 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 a national market system, and to protect investors and the public interest. The Commission believes that extending the pilot will enable Participants to continue to compile the data necessary for the Commission to determine whether permanent approval of the proposed rule change is appropriate and in the public interest. The Commission further believes that raising the limitation in liability for Satisfaction Orders during the last seven minutes of the trading day from 10 contracts to 25 contracts for this pilot period should help to protect investors and promote the public interest.

¹⁰ 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).

¹¹ 15 U.S.C. 78f(b)(5).

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice thereof in the Federal Register. As noted above, the proposed rule change incorporates changes into ISE Rules that correspond to changes made to the Linkage Plan through Joint Amendment No. 12, which was published for public comment in the Federal Register on May 19, 2004.¹² The Commission received no comments in response to publication of Joint Amendment No. 12. The Commission believes that no new issues of regulatory concern are being raised by ISE's proposed rule change. The Commission believes, therefore, that granting accelerated approval of the proposed rule change is appropriate and consistent with Sections 6 and 19(b) of the Act.¹³

¹² See supra note 4.

¹³ 15 U.S.C. 78f and 78s(b).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-ISE-2004-14) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland
Deputy Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).