

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52177; File No. SR-ISE-2005-31)

July 29, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Cancellation Fee Changes

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 June 29, 2005, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change concerning its cancellation fee as described in Items I, II, and II below, which items have been prepared by the ISE. The ISE has filed the proposed rule change as one establishing or changing a due, fee, or other charge imposed by the ISE under Section 19(b)(3)(A)(ii) of the Act³ and Rule 19b-4(f)(2) thereunder,⁴ 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.⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(ii).

⁴ 17 CFR 240.19b-4(f)(2)

⁵ The Commission received eleven comment letters on the proposal as of the date of this notice. The ISE subsequently filed a proposed rule change under Section 19(b)(3)(A) of the Act (File No. SR-ISE 2005-36) to reinstate the Exchange's cancellation fee as in effect prior to the filing of the instant proposed rule change. In addition, the ISE filed a proposed rule change pursuant to Section 19(b)(2) under the Act (File No. SR-ISE-2005-37) that would base its cancellation fee on canceled contracts and that responds to the comment letters submitted on the instant proposed rule change.

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

The purpose of the proposed rule change is to amend the ISE's cancellation fee.

The text of the proposed rule change is available on the Exchange's Internet Web site (http://www.iseoptions.com/legal/proposed_rule_changes.asp), at the principal office of the ISE, 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

The ISE proposes to amend its Schedule of Fees regarding its cancellation fee. Since the inception of the cancellation fee, the Exchange has charged Electronic Access Members ("EAMs") \$1 per order canceled in excess of the number of orders executed.⁶ Recognizing that order cancellations often happen in large numbers, the purpose of the fee was to ease congestion in the ISE Order Routing System ("IORS") and to fairly allocate costs among members according to system use. The Exchange states that experience shows that two limitations are preventing the fee from fully achieving its intended effect. First, the ISE applies the fee to the aggregate number of orders a clearing

⁶ See Securities Exchange Act Release No. 46189 (July 11, 2002), 67 FR 47587 (July 19, 2002) (SR-ISE-2002-16).

EAM cancels on behalf of itself and its customers, which tends to mask the activity of the EAM's particular customers who are responsible for the cancellations. Second, because the Exchange applies the fee on a per order basis, firms have adjusted trading activity solely to avoid this fee by executing small orders to offset the cancellation of larger orders. The ISE states that, if anything, this increases message traffic as firms enter more small orders to mask their order cancellations.

To address these concerns, the ISE first proposes to charge a clearing EAM based on the cancellation activity of each of its customers (including itself when it self-clears). The Exchange has enhanced its systems so that it now can identify the specific broker-dealer customers of a clearing EAM who enters and cancels orders. This will allow the Exchange to identify and charge for cancellation activity beyond aggregate numbers. The ISE similarly will be able to provide clearing EAMs with the information necessary for them to pass through resulting cancellation charges to their customers.⁷

The ISE further proposes to apply the fee to contracts canceled, not orders canceled. Specifically, the Exchange would charge \$.10 for a canceled contract, compared to the current \$1.00 fee for each canceled order. Similarly, the Exchange proposes to charge the fee only if the member or customer canceled at least 5,000 contracts in a month, compared to the current rule's allowance of 500 canceled orders. The Exchange believes that this will help address the problem of firms executing multiple small orders to avoid the per-order fee. The Exchange also believes that this will result in an effective fee increase since its current average order size is approximately 17 contracts, resulting in an average fee of \$1.70 per canceled order. The ISE believes this

⁷ The ISE notes that this feature is similar to how the Pacific Exchange now imposes its cancellation fee. See Securities Exchange Act Release No. 49802 (June 3, 2004), 69 FR 32391 (June 9, 2004) (SR-PCX-2004-31).

increase is justified due to a continued increase in cancellation activity and its effect on IORS congestion.

To ensure that the Exchange covers only activity that is truly excessive and inappropriately uses bandwidth and system capacity, it proposes to charge the fee only if canceled contracts are in excess of five times the total number of contracts executed. If this five-to-one ratio is exceeded, as is the case today with orders, the Exchange will impose the fee only on the excess cancellations over executions.

The following example shows how the ISE proposes to apply this fee: Assume that Firm A, a customer of Clearing EAM, cancels orders representing an aggregate of 13,000 contracts in a month. Further assume that Firm A executed orders representing 2,500 contracts. Because the 13,000 contracts canceled is both (1) greater than the base level of 5,000 contracts and (2) more than five times in excess of the 2,500 contracts executed (which would be 12,500 contracts), the ISE would impose the fee on an aggregate of 10,500 contracts (13,000 contracts canceled minus the 2,500 contracts executed). The fee on Clearing EAM would be \$1,050, which would have the information necessary to pass the charge to its customer, Firm A.

2. Statutory Basis

The ISE states that the basis for the proposed rule change is the requirement under Section 6(b)(4) of the Act,⁸ that an exchange have an equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities. In particular, these fees would permit the Exchange to recover capacity costs more equitably among its members.

⁸ 15 U.S.C. 78f(b)(4).

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

The ISE states that the proposed rule change does not impose in 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.

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

Because the foregoing proposed rule change establishes or changes a due, fee, or other charged imposed by the Exchange, it has become effective pursuant to Section 19(b)(3) of the Act⁹ and Rule 19b-4(f)(2)¹⁰ thereunder. At any time within 60 days of the filing of the proposed rule change the Commission may summarily abrogate such proposed 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 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:

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 19b-4(f)(2).

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 SR-ISE-2005-31 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 SR-ISE-2005-31. 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 the filing also will be available for inspection and copying at the principal office of the Exchange. 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 SR-ISE-2005-31 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.¹¹

Margaret H. McFarland
Deputy Secretary

¹¹ 17 CFR 200.30-3(a)(12).