

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53104; File No. SR-ISE-2006-02)

January 11, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Directed Orders System Change

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 5, 2006, 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, II, and III below, which Items have been prepared by the ISE. The proposed rule change has been filed by the ISE as effecting a change in an existing order-entry or trading system pursuant to Section 19(b)(3)(A) of the Act,³ and Rule 19b-4(f)(5) 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.

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

The ISE is proposing to change its existing system as it relates to “Directed Orders.” Specifically, the Exchange is proposing to identify to a Directed Market Maker (“DMM”) the identity of the firm entering a Directed Order. This system change will be effective until June 30, 2006, while the Commission considers a corresponding ISE proposal to amend its rules to specify that order-entry firm identity is disclosed to the DMM. In addition, the Exchange

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(5).

commits that it will reverse this system change prior to June 30, 2006, if the Commission staff prohibits all options exchanges from disclosing the identity of order entry firms in their directed order systems. In that case, the Exchange will reverse this system change effective simultaneously with all other exchanges enforcing anonymity in their systems.⁵ The text of the proposed rule change is available on the ISE's 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 Exchange operates a Directed Order system in which Electronic Access Members ("EAMs") can send an order to a DMM for possible price improvement.⁶ If a DMM accepts Directed Orders generally, that DMM must accept all Directed Orders from all EAMs. Once such a DMM receives a Directed Order, it either must enter the order into the Exchange's "Price

⁵ In the event that the issue of anonymity in the Directed Order process is not resolved by June 30, 2006, the Exchange intends to submit another filing under Rule 19b-4(f)(5) extending this temporary system change.

⁶ See Securities Exchange Act Release No. 52331 (August 24, 2005), 70 FR 51856 (August 31, 2005) (SR-ISE-2004-16).

Improvement Mechanism” (“PIM”) or must release the order into the Exchange’s limit order book, in which case there are certain restrictions on the DMM interacting with the order. While ISE rules do not specify that Directed Orders are sent to a DMM on an anonymous basis, prior to this filing, the Exchange did not disclose to a DMM the identity of the EAM sending a Directed Order.

The Boston Options Exchange (“BOX”) operates a system almost identical to ISE’s Directed Order system, with one important distinction. Based on BOX’s published rules, ISE believed that BOX’s system had the same anonymity feature as ISE’s system. However, BOX’s system is not in fact anonymous, and its system provides BOX directed market makers with the identity of the firm entering an order.⁷ ISE’s market makers find this feature very attractive in that it provides a DMM with relevant information when deciding whether or not to guarantee price improvement for an order. Without ISE also disclosing the identity of the order entry firm, ISE’s Directed Order system is not competitive with the BOX’s system. While the Boston Stock Exchange, Inc. (“BSE”) has filed a proposed rule change to conform the BOX rules to the actual operation of its system,⁸ BOX continues to identify firms entering directed orders while the Commission considers the pending rule filing.

ISE believes that BOX has been non-compliant with its rules and that this places the ISE at a significant competitive disadvantage. ISE further believes that the only way that ISE can address the immediate inequity in the market is to modify ISE’s system to disclose the identity of the EAM entering a Directed Order on a temporary basis while the Commission considers whether to approve the BOX Proposal. Thus, the purpose of this filing is to remove the

⁷ See Securities Exchange Act Release No. 53015 (December 22, 2005), 70 FR 77207 (December 29, 2005) (the “BOX Proposal”).

⁸ Id.

anonymity feature from ISE's Directed Order system for a period ending on June 30, 2006. This system change is effective on filing under Rule 19b-4(f)(5). The ISE has simultaneously filed a proposed rule change, similar to the BOX Proposal, to specify in its rules that the identity of the entering firm is disclosed to a DMM,⁹ which if approved by the Commission, will make the system change permanent (the "Permanent Rule Change").¹⁰ The Permanent Rule Change has been filed pursuant to Section 19(b)(2) of the Act to provide the Commission an opportunity to consider both the BOX and ISE proposals contemporaneously.

Through this proposal, the ISE will be able to operate on an equal competitive basis with BOX while the Commission evaluates whether exchanges should be permitted to disclose order flow provider identities. The ISE commits that it will submit another rule change under Rule 19b-4(f)(5) to reverse this system change prior to June 30, 2006, if the Commission staff determines not to approve the Permanent Rule Change and the BOX Proposal and prohibits all options exchanges from disclosing the identity of order entry firms in their directed order systems. In that case, the Exchange will reverse this system change effective simultaneously with BOX, and all other options exchanges having similar systems, enforcing anonymity in their systems.

⁹ See Securities Exchange Act Release No. 53103 (January 11, 2006) (File No. SR-ISE-2006-01).

¹⁰ The ISE also enforces anonymity in certain other trading systems, such as its Facilitation Mechanism. The Exchange also plans to file a proposed rule change eliminating the anonymity provisions in certain of these areas.

2. Statutory Basis

The Exchange believes that the basis under the Act is found in Section 6(b)(5),¹¹ in that the proposed rule change is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to 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. In particular, the system change will enable the Exchange to remain competitive in the market place while the Commission considers anonymity issues across all options markets.

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

The Exchange 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.

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

Because the foregoing proposed rule change effects a change in an existing order entry or trading system that (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not have the effect of limiting access to or availability of the system, it has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act¹² and Rule 19b-4(f)(5) thereunder.¹³

¹¹ 15 U.S.C. 78f(b)(5).

¹² 15 U.S.C. 78s(b)(3)(A)(iii).

¹³ 17 CFR 19b-4(f)(5).

At any time within 60 days of the filing of such 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 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 No. SR-ISE-2006-02 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-ISE-2006-02. 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-2006-02 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Nancy M. Morris
Secretary

¹⁴ 17 CFR 200.30-3(a)(12).