

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49956; File No. SR-ISE-2004-19)

July 1, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the International Securities Exchange, Inc. Relating to Electronically Generated Orders

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 27, 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, II and III below, which Items have been prepared by the Exchange. On June 30, 2004, the ISE filed Amendment No. 1 to the proposed rule change.³ 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 proposes to amend Rule 717(f) to allow electronically generated market orders, immediate-or-cancel limit orders, and fill-or-kill limit orders. The text of the proposed rule change is as follows, with additions indicated in italics:

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated June 29, 2004 (“Amendment No. 1”). In Amendment No. 1, the Exchange clarified certain language in the purpose section. The substance of Amendment No. 1 has been incorporated into this notice.

Rule 717. Limitations on Orders

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(f) Electronic Orders.

Members may not enter, nor permit the entry of, orders created and communicated electronically without manual input (i.e., order entry by Public Customers or associated persons of Members must involve manual input such as entering the terms of an order into an order-entry screen or manually selecting a displayed order against which an off-setting order should be sent), unless such orders are (1) non-marketable limit orders to buy (sell) that are priced higher (lower) than the best bid (offer) on the Exchange (i.e., limit orders that improve the best price available on the Exchange), (2) limit orders that are designated as fill-or-kill or immediate-or-cancel, or (3) market orders. Nothing in this paragraph, however, prohibits Electronic Access Members from electronically communicating to the Exchange orders manually entered by customers into front-end communications systems (e.g., Internet gateways, online networks, etc.).

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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 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 IV below. 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

Currently, under ISE Rule 717(f), Electronic Access Members (“EAMs”) are not permitted to enter orders that are generated and communicated electronically without human intervention unless such orders are non-marketable limit orders that improve the Exchange’s best bid or offer. The Exchange represents that one purpose of this rule is to limit the ability of non-market makers to effectively make markets on the Exchange using automated systems that place and cancel orders in a manner that is similar to quoting.⁴

As a general matter, the Exchange believes that maintaining the prohibition on electronically generated orders is important to prevent EAMs from acting like market makers without also being subject to the responsibilities of market makers. However, the Exchange believes that certain types of electronically-generated orders do not raise these concerns. Specifically, the Exchange proposes to allow the electronic generation of orders that are not eligible to rest on the limit order book, as the Exchange believes that these types of orders do not present the same “market making” potential as resting limit orders. Such orders include market orders, fill-or-kill limit orders, and immediate-or-cancel limit orders.⁵ By allowing these types of orders, which are not eligible to rest on the limit order book, but maintaining the prohibition

⁴ The ISE represents that, while most of the options exchanges currently maintain a similar prohibition on electronically generated orders (see, e.g., American Stock Exchange Rule 934, Chicago Board Options Exchange Rule 6.8A, and Pacific Exchange Rule 6.88), the Philadelphia Stock Exchange has removed its limitations on electronically generated orders. See Securities Exchange Act Release No. 48648 (October 16, 2003) 68 FR 60762 (October 23, 2003) (approving SR-Phlx-2003-37).

⁵ These order types are defined in ISE Rule 715.

on other electronically generated limit orders, the Exchange believes the right balance will be achieved.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act⁶ in general and furthers the objectives of Section 6(b)(5) of the Act⁷ in particular, because it is 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 of a free and open market and a national market system, and, in general, to protect investors and the public interest. In particular, the Exchange believes that the proposed rule change will benefit investors by allowing them to electronically generate additional types of orders.

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

The Exchange does not believe that the proposed rule change will 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

No written comments were solicited or received with respect to the proposed rule change.

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

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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-2004-19 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-2004-19. 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 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 File Number SR-ISE-2004-19 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.⁸

Margaret H. McFarland
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).