

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53271; File No. SR-ISE-2005-46)

February 10, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving a Proposed Rule Change Relating to the Operation of Primary Market Maker Memberships

I. Introduction

On September 27, 2005, the International Securities Exchange, Inc. (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rules to increase the maximum number of Primary Market Maker (“PMM”) memberships that an ISE member may operate from two PMM memberships to three PMM memberships. The proposed rule change was published for comment in the Federal Register on December 6, 2005.<sup>3</sup> The Commission received no comment letters regarding the proposal. This order approves the proposed rule change.

II. Description of Proposed Rule

The Exchange proposes to amend ISE Rule 303(b) to increase from two to three the maximum number of PMM memberships that an ISE member may operate. According to ISE’s Certificate of Incorporation (“Certificate”)<sup>4</sup> and ISE’s Amended and Restated Constitution (“Constitution”),<sup>5</sup> each PMM membership is represented by a single share of ISE Class B

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 52856 (November 30, 2005), 70 FR 72684 (December 6, 2005) (“Notice”).

<sup>4</sup> See Article Fourth, Section II(b)(ii)(A) of the Certificate.

<sup>5</sup> See Article XIII, Section 13.1 of the Constitution.

Common Stock, Series B-1, of which there are 10 shares authorized and outstanding.<sup>6</sup> ISE represents that it currently has seven PMMs operating the ten PMM memberships; three PMMs each operate two PMM memberships, and the remaining four PMMs each operate one PMM membership. ISE's Certificate prohibits an ISE member from owning or voting the shares representing more than 20% of any class or series of ISE capital stock.<sup>7</sup> Current ISE Rule 303(b) prohibits an ISE member from exercising the trading privileges associated with (i.e., operating) more than one PMM membership, but permits the ISE Board of Directors ("ISE Board") to waive this restriction and allow an ISE member (together with its affiliates) to exercise the trading privileges associated with 20% of the outstanding PMM memberships. To waive this restriction, the ISE Board must make a finding of "good cause."<sup>8</sup> Taken together, ISE's Certificate and ISE Rule 303(b) currently prohibit an ISE member from owning, voting, or operating more than 20% of the outstanding PMM memberships.<sup>9</sup>

The proposed rule change would amend ISE Rule 303(b) to increase the maximum number of PMM memberships an ISE member may operate, upon the ISE Board's approval, from 20% of the outstanding PMM memberships (two PMM memberships) to 30% of the outstanding PMM memberships (three PMM memberships). The proposed rule change also

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<sup>6</sup> See Article Fourth, Section II(b)(i) of the Certificate.

<sup>7</sup> See Article Fourth, Sections III(a)(ii) and (b)(i) of the Certificate.

<sup>8</sup> Supplementary Material .01 to ISE Rule 303 provides that the ISE Board, when making its determination of whether good cause has been shown, the ISE Board must consider whether an operational, business or regulatory need to operate more than one PMM membership has been demonstrated. It further provides that the ISE Board is only allowed to approve the operation of additional PMM memberships when, in its judgment, such action is in the best interest of the Exchange.

<sup>9</sup> The Commission notes that ISE recently filed a proposed rule change that would restructure the Exchange but would retain its existing 20% ownership and voting limitations applicable to ISE members as part of the proposed reorganization. See File No. SR-ISE-2006-04.

would add proposed Supplementary Material .02 to ISE Rule 303, which would prohibit the ISE Board from approving any such arrangement in which a PMM would gain ownership or voting rights in excess of those permitted under ISE's Certificate or Constitution. Because the proposal would not alter the 20% ownership and voting limits currently set forth in ISE's Certificate that apply to ISE members, the proposal would allow a member to operate up to 30% of the outstanding PMM memberships, upon receiving Board approval, but only in the event that such member did not own or vote more than 20% of such PMM memberships.

### III. Discussion

After careful review, 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.<sup>10</sup> In particular, the Commission believes that the proposal is consistent with the requirements of Section 6(b)(5) of the Act,<sup>11</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanisms of a free and open market and a national market system.

The Commission notes that the proposed change to ISE Rule 303(b) would increase the maximum number of PMM memberships that an ISE member could operate from two to three PMM memberships. The provisions of ISE's Certificate that currently prohibit an ISE member from owning, directly or indirectly, or voting more than 20% of the outstanding shares of any class or series of ISE capital stock would not be altered by this proposal. Rather, in proposed Supplementary Material .02 to ISE Rule 303, the ISE Board would be prohibited from allowing a

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<sup>10</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

member to operate a third PMM membership if such an arrangement would violate any ownership and voting limits contained in ISE's Certificate or Constitution. In essence, the proposal would permit the Board to approve an ISE member to acquire the trading privileges to operate a third PMM membership through a leasing arrangement with an unaffiliated person or entity, where the lessor retains all of the ownership and voting rights associated with that PMM membership.

As the Commission has stated previously, a regulatory concern can arise if a member's interest in an exchange becomes so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.<sup>12</sup> For example, a member that directly or indirectly controls an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from diligently monitoring and surveiling the member's conduct or diligently enforcing its rules and the federal securities laws with respect to conduct by the member that violates such provisions.

The Commission believes that the proposal would not give rise to concerns about the Exchange's ability to effectively carry out its regulatory responsibilities under the Act because the proposed rule change preserves existing ownership and voting limitations.

In light of the foregoing, the Commission believes that the Exchange's proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder.

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<sup>12</sup> See Securities Exchange Act Release Nos. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08); 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73); and 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (SR-BSE-2003-19).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (File No. SR-ISE-2005-46) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

Nancy M. Morris  
Secretary

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<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).