

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49966; File No. SR-ISE-2004-07)

July 2, 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 the Handling of Satisfaction Orders Pursuant to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage

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 March 4, 2004, the International Securities Exchange, Inc. (“ISE” or “Exchange”) submitted to 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.

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

The ISE is proposing to amend the requirements regarding how its members handle Satisfaction Orders³ pursuant to the Linkage Plan.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ A “Satisfaction Order” is defined as an order sent through the Options Intermarket Linkage (“Linkage”) to notify a Participant of a Trade-Through and to seek satisfaction of the liability arising from that Trade-Through. A “Trade-Through” is a transaction in an options series at a price that is inferior to the National Best Bid or Offer. See Sections 2(16)(c) and 2(29) of the Purpose of Creating and Operating an Intermarket Option Linkage (“Linkage Plan”), respectively.

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 had 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 this filing is to implement a proposed rule change related to proposed Joint Amendment No. 11 to the Linkage Plan.⁴ That amendment to the Linkage Plan, together with this proposed rule change, will enhance the manner in which the ISE processes Satisfaction Orders following a Trade-Through. If the displayed price that is traded through represents a customer order, the ISE Primary Market Maker ("PMM") or a member of another participant in the Linkage Plan ("Participant")⁵ can send a Satisfaction Order requiring the member on the exchange who caused the Trade-Through to satisfy the customer order.⁶ While the ISE believes

⁴ See Securities Exchange Act Release No. 49691 (May 12, 2004), 69 FR 28954 (May 19, 2004) (File No. 4-429) (Notice of filing Joint Amendment No. 11 to the Linkage Plan).

⁵ 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.

⁶ See Sections 7(a)(ii)(D) and 8(c)(ii) of the Linkage Plan.

that this process generally works well, the experience with Linkage to date has led the options exchanges to agree to implement three changes to Satisfaction Order processing.

First, Section 8(c)(ii)(B)(2) of the Linkage Plan and ISE Rule 1902 (the "Rule") currently permit a PMM to send a Satisfaction Order for the full size of the customer order traded through, regardless of the size of the transaction that caused the Trade-Through (although the Participant receiving the Satisfaction Order that elects to execute it must limit its execution to the size of the Trade-Through). This proposed rule change would limit the size of the Satisfaction Order to the lesser of the size of the customer order traded through and the size of the transaction that caused the Trade-Through.

Second, the Linkage Plan⁷ and the Rule currently permit a PMM to reject an execution ("fill") of a Satisfaction Order if the customer order that underlies the Satisfaction Order either has been filled on the ISE or has been canceled while the Satisfaction Order is being processed. However, if the order is filled or canceled, there is no current requirement to cancel the pending Satisfaction Order, which leads to the rejection of Satisfaction Order fills that may have been avoided had the Satisfaction Order been canceled. To address this issue, the proposed rule change would require the PMM to cancel a pending Satisfaction Order as soon as practical if the underlying customer order is filled or canceled.

Third, as noted above, a PMM can reject a Satisfaction Order fill if the underlying customer order is executed or canceled while the Satisfaction Order is pending. However, it is possible that the PMM itself could trade against the customer order before the PMM receives a notice that the Satisfaction Order has been filled. In this case, the ISE believes that it would be

⁷ See Section 8(c)(ii)(C) of the Linkage Plan.

inappropriate to reject the fill. Accordingly, the proposed rule change would provide that the PMM must accept the fill of the Satisfaction Order in that scenario.

2. Statutory Basis

The ISE believes that the proposed rule is consistent with Section 6(b) of the Act,⁸ in general, and furthers the objectives of Section 6(b)(5)⁹ in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities. In particular, the Exchange believes that the proposed rule change will enhance the national market system for options by improving the way all Participants handle Satisfaction Orders.

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

The ISE does not believe that the proposed rule change will impose any burden on competition 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. 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:

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

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-2004-07 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-2004-07. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. 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-2004-07 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 an 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 the proposed rule change should facilitate the handling of Satisfaction Orders in an efficient and fair manner.

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 the ISE Rules that correspond to changes made to the Linkage Plan through Joint Amendment No. 11, 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. 11. The Commission believes that no new issues of regulatory concern are being raised by ISE's proposed rule change. The

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).

¹² See supra note 4.

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

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-ISE-2004-07) 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

¹³ 15 U.S.C. 78f and 78s(b).

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).