

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51256; File No. SR-ISE-2005-10)

February 25, 2005

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the International Securities Exchange, Inc., Relating to Listing Standards for Options on Narrow-Based Securities Indexes

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 February 14, 2005, 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. On February 23, 2005, the Exchange amended its proposal.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons, and is approving the proposal on an accelerated basis.

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

The ISE is proposing to amend its rules relating to listing standards for options on narrow-based security indexes. The text of the proposed rule change is as follows (italics indicate additions; [brackets] indicate deletions):

* * * * *

Rule 2002. Designation of an Index

(a) No Change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Amendment No. 1, dated February 23, 2005 (“Amendment No. 1”). In Amendment No. 1, the Exchange supplemented its description of the modified market capitalization methodology. Amendment No. 1 replaced the ISE’s original filing in its entirety.

(b) The Exchange may trade options on a narrow-based index pursuant to Rule 19b-4(e) of the Securities Exchange Act of 1934, if each of the following conditions is satisfied:

(1) No Change.

(2) The index is capitalization-weighted, price-weighted, [or] equal dollar-weighted, or modified capitalization-weighted, and consists of 10 or more component securities;

(3) – (4) No Change.

(5) In a capitalization-weighted index or a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30 percent of the total number of component securities in the index each have had an average monthly trading volume of at least 2,000,000 shares over the past six months;

(6) – (12) No Change.

(c) The following maintenance listing standards shall apply to each class of index options originally listed pursuant to paragraph (b) above:

(1) – (3) No Change.

(4) In a capitalization-weighted index or a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30 percent of the total number of stocks in the index each have had an average

monthly trading volume of at least 1,000,000 shares over the past six months. In the event a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth herein, the Exchange shall not open for trading any additional series of options of that class unless such failure is determined by the Exchange not to be significant and the SEC concurs in that determination, or unless the continued listing of that class of index options has been approved by the SEC under Section 19(b)(2) of the Exchange Act.

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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 self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change, as amended, and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item III below. The self-regulatory organization 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 is proposing to amend ISE Rule 2002(b). ISE Rule 2002(b) contains generic listing standards for narrow-based index options pursuant to Rule 19b-4(e) of the Act.⁴ Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization shall not be deemed a proposed rule change, pursuant to paragraph (c)(1)

⁴ 17 CFR 240.19b-4(e).

of Rule 19b-4,⁵ if the Commission has approved, pursuant to Section 19(b) of the Act,⁶ the self-regulatory organization's trading rules, procedures and listing standards for the product class that would include the new derivatives securities product, and the self-regulatory organization has a surveillance program for the product class.⁷ Thus, ISE Rule 2002(b) allows the Exchange to list options on a narrow-based securities index pursuant to Rule 19b-4(e) under the Act without having to submit a formal rule change under Section 19(b) of the Act as long as the requisite criteria provided for under ISE Rule 2002(b) are met.⁸ One of these criteria, provided under ISE Rule 2002(b)(2), requires that the subject index be capitalization-weighted, price-weighted, or equal-dollar weighted and consist of ten or more component securities.

The Exchange hereby proposes to amend ISE Rule 2002(b)(2) to include a "modified capitalization-weighted" methodology as an acceptable generic listing standard for options on a narrow-based index.⁹ The modified capitalization-weighted methodology is already an approved

⁵ 17 CFR 240.19b-4(c)(1).

⁶ 15 U.S.C. 78s(b).

⁷ See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (the "19b-4(e) Order"). Telephone conversation between Samir Patel, Assistance General Counsel, ISE, and Florence E. Harmon, Senior Special Counsel, Division of Market Regulation ("Division"), Commission, on February 24, 2005.

⁸ See Securities Exchange Act Release No. 47749 (April 25, 2003); 68 FR 23507 (May 2, 2003) (Order approving rules relating to trading options on indices, including ISE Rule 2002(b) – Generic Narrow-Based Index Option Listing Criteria).

⁹ A modified capitalization-weighted index is similar to a capitalization-weighted index where the components are weighted according to the total market value of the outstanding shares, except that an adjustment to the weighting of one or more of the component occurs. This type of methodology is expected to: (1) retain the economic attributes of capitalization weighting; (2) promote portfolio weight diversification; (3) reduce performance distortion by preserving the capitalization ranking of companies; and (4) reduce market impact on the smallest component securities from necessary weight rebalancing.

criterion for securities indexes¹⁰ and is an established method of weighting securities indexes.¹¹ Accordingly, the ISE proposes to adopt the modified capitalization-weighted methodology as a standard for listing options on narrow-based indexes that satisfy the Exchange's generic listing criteria for options on narrow-based securities indexes under ISE Rule 2002(b).

2. Basis

The Exchange believes the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act. Specifically, the Exchange believes the proposed rule change, as amended, is consistent with Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. The adoption of the proposed rule change, as amended, would enable the ISE to begin listing and trading options on new narrow-based indexes.

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

The Exchange believes that the proposed rule change, as amended, does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

¹⁰ The Chicago Board Options Exchange's ("CBOE") generic listing standards for micro narrow-based securities indexes, CBOE Rule 24.2(d)(2), includes modified capitalization-weighted methodology as an approved criteria. See Securities Exchange Act Release No. 49932 (June 28, 2004); 69 FR 40994 (July 7, 2004) (Order approving CBOE's micro narrow-based securities index generic listing standards).

¹¹ For example, the Nasdaq-100 Index is calculated using the modified capitalization-weighted methodology.

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, as amended. The Exchange has not received any unsolicited written comments from members or other interested parties.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2005-10 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-2005-10. 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-2005-10 and should be submitted by [insert date 21 days from the date of 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, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) thereunder.¹² The proposed rule change would facilitate the listing and trading of options on certain types of narrow-based securities indexes on the Exchange for the benefit of its members and their customers, specifically those that are calculated using the modified capitalization-weighted methodology and otherwise meet all applicable generic listing standards under ISE Rule 2002(b). Accordingly, the Commission believes that approving this proposed rule change, as amended, would promote a fair, orderly, and competitive options market.

The Exchange has requested that this proposed rule change be given accelerated effectiveness pursuant to Section 19(b)(2) of the Act.¹³ The Commission finds good cause for approving this proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. The Commission believes that accelerating the effectiveness of the proposed rule change, as amended, would facilitate the availability of

¹² 15 U.S.C. 78f(b)(5).

¹³ 15 U.S.C. 78s(b)(1).

additional investment choices to investors. In addition, the Commission notes that it has previously approved the modified market capitalization methodology in generic listing standards for other derivative products. Accordingly, the Commission believes that there is good cause, consistent with Sections 6(b)(5) and 19(b)(2) of the Act,¹⁴ to approve the proposal, as amended, on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁵ that the proposed rule change (SR-ISE-2005-10), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland
Deputy Secretary

¹⁴ 15 U.S.C. 78f(b)(5) and 78s(b)(2).

¹⁵ 15 U.S.C. 78s(b)(2).

¹⁶ 17 CFR 200.30-3(a)(12).