

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53419; File No. SR-ISE-2005-50)

March 6, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving Proposed Rule Change, and Amendment No. 1 Thereto, to Amend ISE Rule 803 to Provide for a Back-Up Primary Market Maker

I. Introduction

On October 14, 2005, the International Securities Exchange, Inc. ("Exchange" or "ISE") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend ISE Rule 803 to provide for a Back-Up Market Maker. On January 12, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.³ The proposed rule change was published for comment in the Federal Register on January 30, 2006.⁴ The Commission received no comment letters regarding the proposal. This order approves the proposed rule change, as amended.

II. Description of Proposed Rule

The Exchange proposes to amend ISE Rule 803 to provide for a Back-Up Primary Market Maker and to correct an inconsistency in the Exchange's Rules. Specifically, the Exchange proposes to enhance the ISE System to allow Competitive Market Makers that are also Primary Market Makers on the Exchange to voluntarily act as Back-Up Primary

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1, which replaced the original filing in its entirety, made technical and clarifying changes to the proposed rule change.

⁴ See Securities Exchange Act Release No. 53164 (January 20, 2006), 71 FR 4949 (January 30, 2006)("Notice").

Market Makers when the appointed Primary Market Maker experiences technical difficulties that interrupt its participation in the market. Under the proposal, only Competitive Market Makers that are also Primary Market Makers on the Exchange would be eligible to be designated as a Back-Up Primary Market Maker because, according to the Exchange, these members are readily able to assume all of the responsibilities of a Primary Market Maker on the Exchange, such as handling customer orders when an away market has a better price.

Under the proposed rule change, the ISE System would automatically switch a Competitive Market Maker quoting in the affected options series to an active Back-Up Primary Market Maker if the appointed Primary Market Maker stops quoting as a result of technical difficulties.⁵ The ISE System would automatically switch back to the appointed Primary Market Maker when it re-establishes its quotes in the series, but the Back-Up Primary Market Maker would continue to be responsible for any outstanding unexecuted orders it is handling. During the period that the services of the Back-Up Primary Market Maker are required, it would assume most of the responsibilities and privileges of a Primary Market Maker under the ISE Rules with respect to any series in which the appointed Primary Market Maker fails to have a quote in the ISE System.⁶

The Exchange also proposes to correct an inconsistency in its rules. In April 2004, the Exchange received Commission approval of a proposed rule change that

⁵ If there is more than one eligible member quoting in the series, the ISE System would automatically switch to the member with the largest offer in the series.

⁶ A Competitive Market Maker would not become subject to the requirement in ISE Rule 804(e)(1) to enter continuous quotations in all of the series of all of the options classes to which it is appointed, as opposed to only 60% of the options classes under ISE Rule 804(e)(2), by acting as a Back-Up Primary Market Maker.

allowed it to disseminate a quotation for less than ten contracts.⁷ Because the options intermarket linkage plan and the Exchange's rules continued to require the Exchange to guarantee that the Firm Customer Quote Size ("FCQS") and Firm Principal Quote Size ("FPQS") would be at least 10 contracts, ISE Rule 803(c)(1) was amended to provide that the Primary Market Maker had the obligation to buy or sell the number of contracts necessary to provide an execution of at least 10 contracts to incoming linkage orders when the Exchange's disseminated market quotation was for less than 10 contracts.⁸

In August 2004, the intermarket linkage plan was amended to provide that the 10 contract minimum FCQS and FPQS does not apply when the Exchange is disseminating a quotation of fewer than 10 contracts.⁹ In October 2004, the Exchange, and all of the other options exchanges, received approval for changes to their linkage rules to implement this change to the intermarket linkage plan.¹⁰ Accordingly, the Primary Market Maker no longer is required to guarantee a minimum of 10 contracts to an incoming linkage order when the Exchange's disseminated market quotation is for less than 10 contracts. However, the Exchange neglected to remove the language in ISE Rule 803(c)(1) at the time the changes to the linkage rules were approved, thereby creating an inconsistency in the ISE Rules. The Exchange now proposes to delete the language in ISE Rule 803(c)(1) as a purely non-substantive clean-up of the ISE Rules.

⁷ See Exchange Act Release No. 49602 (April 22, 2004), 69 FR 23841 (April 30, 2004) (the "Real Size Filing").

⁸ See id.

⁹ See Exchange Act Release No. 50211 (August 18, 2004), 69 FR 52050 (August 24, 2004).

¹⁰ See Exchange Act Release Nos. 50562 (October 19, 2004), 69 FR 62925 (October 28, 2004) and 50587 (October 25, 2004), 69 FR 63417 (November 1, 2004).

III. Discussion

After careful review, 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.¹¹ In particular, the Commission finds that the proposal is consistent with the requirements of Section 6(b)(5) of the Act,¹² which requires, among other things, that the rules of a national securities 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 proposal should help to ensure that the functions of the Primary Market Maker are performed in an uninterrupted fashion even when a Primary Market Maker experiences difficulties that cause it to remove its quotes from the market. In particular, the Commission believes that the proposed rule change should help to ensure that the Back-Up Primary Market Makers would provide continuous quotations in all of the series of the options classes in a manner consistent with the obligations of the Primary Market Maker, set forth in ISE Rule 803. Further, this proposed rule change should reduce the number of non-firm quotes or “fast market” states disseminated by the ISE.¹³

¹¹ 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).

¹² 15 U.S.C. 78f(b)(5).

¹³ The Commission notes that the Exchange represents that most interruptions in Primary Market Maker quoting are very brief in duration. Telephone conversation between Katherine Simmons, Deputy General Counsel, ISE, Marc F. McKayle, Special Counsel, Division of Market Regulation (“Division”),

The ISE proposal to indicate that a Primary Market Maker is not required to guarantee a minimum of 10 contracts to an incoming linkage order when the Exchange's disseminated market quotation is less than 10 contracts is of a clarifying and technical nature. Accordingly, based on the foregoing the Commission believes that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-ISE-2005-50) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Nancy M. Morris
Secretary

Commission and Johnna B. Dumler, Attorney, Division, Commission on November 2, 2005.

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).