

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53857; File No. SR-ISE-2006-24)

May 24, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto to Permit the Listing and Trading of Quarterly Options Series

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 2, 2006, 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 substantially prepared by the Exchange. The Exchange filed Amendment No. 1 to the proposed rule change on May 17, 2006.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The ISE proposes to amend its rules in order to list option series that expire at the close of business on the last business day of a calendar quarter. This rule change is being proposed on a pilot basis for one year. The text of the proposed rule change, as amended, is set forth below. Proposed new language is underlined; deletions are in [brackets].

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, a partial amendment, the Exchange made minor modifications to the proposed rule text.

Rule 100. Definitions

(a) The following terms, when used in these Rules, shall have the meanings specified in this Chapter 1, unless the context indicates otherwise. Any term defined in Article I of the Constitution and not otherwise defined in this Chapter shall have the meaning assigned in Article I of the Constitution.

(1) through (34) No change.

(35) The term “Quarterly Options Series” means a series in an options class that is approved for listing and trading on the Exchange in which the series is opened for trading on any business day and that expires at the close of business on the last business day of a calendar quarter.

(35) through (44) Renumbered as (36) through (45).

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Rule 504. Series of Options Contracts Open for Trading

(a) After a particular class of options has been approved for listing and trading on the Exchange, the Exchange from time to time may open for trading series of options in that class. Only options contracts in series of options currently open for trading may be purchased or written on the Exchange. Prior to the opening of trading in a given series, the Exchange will fix the expiration month, year and exercise price of that series. For Short Term Option Series, the Exchange will fix a specific expiration date and exercise price, as provided in Supplementary Material .02. For Quarterly Options Series, the Exchange will fix a specific expiration date and exercise price, as provided in Supplementary Material .03.

(b) through (h) No change.

Supplementary Material to Rule 504

.01 No change.

.02 No change.

.03 Quarterly Options Series Pilot Program: For a one-year pilot period, the Exchange may list and trade options series that expire at the close of business on the last business day of a calendar quarter (“Quarterly Options Series”). The Exchange may list Quarterly Options Series for up to five (5) currently listed options classes that are either index options or options on exchange traded funds. In addition, the Exchange may also list Quarterly Options Series on any options classes that are selected by other securities exchanges that employ a similar pilot program under their respective rules. The one-year pilot will commence the day the Exchange first initiates trading in a Quarterly Options Series, which shall be no later than July 24, 2006.

(a) The Exchange will list series that expire at the end of the next consecutive four (4) calendar quarters, as well as the fourth quarter of the next calendar year. For example, if the Exchange is trading Quarterly Options Series in the month of May 2006, it will list series that expire at the end of the second, third and fourth quarters of 2006, as well as the first and fourth quarters of 2007. Following the second quarter 2006 expiration, the Exchange will add series that expire at the end of the second quarter of 2007.

(b) The Exchange will not list a Short Term Option Series on an options class whose expiration coincides with that of a Quarterly Options Series on that same options class.

(c) The strike price of each Quarterly Options Series will be fixed at a price per share, with at least two strike prices above and two strike prices below the value of the underlying security at about the time that a Quarterly Options Series is opened for trading on the Exchange. Additional Quarterly Options Series of the same class may be opened for trading on the

Exchange when the Exchange deems it necessary to maintain an orderly market, to meet customer demand or when the market price of the underlying security moves substantially from the initial exercise price or prices. The opening of new Quarterly Options Series shall not affect the series of options of the same class previously opened.

(d) The interval between strike prices on Quarterly Options Series shall be the same as the interval for strike prices for series in that same options class that expire in accordance with the normal monthly expiration cycle.

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Rule 2001. Definitions

(a) through (k) No change.

(l) The term “Quarterly Options Series” means, for the purposes of Chapter 20, a series in an index options class that is approved for listing and trading on the Exchange in which the series is opened for trading on any business day and that expires at the close of business on the last business day of a calendar quarter.

(l) through (n) Renumbered as (m) through (o).

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Rule 2004. Position Limits for Broad-Based Index Options

(a) through (c) No change.

(d) Positions in Short Term Option Series and Quarterly Options Series shall be aggregated with positions in options contracts on the same index.

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Rule 2005. Position Limits for Industry Index Options

(a) through (c) No change.

(d) Positions in Short Term Option Series and Quarterly Options Series shall be aggregated with positions in options contracts on the same index.

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Rule 2009. Terms of Index Options Contracts

(a) through (e) No change.

Supplementary Material to Rule 2009

.01 No change.

.02 Quarterly Options Series Pilot Program: Notwithstanding the restriction in Rule 2009(a)(3), for a one-year pilot period, the Exchange may list and trade options series that expire at the close of business on the last business day of a calendar quarter (“Quarterly Options Series”). The Exchange may list Quarterly Options Series for up to five (5) currently listed options classes that are either index options or options on exchange traded funds. In addition, the Exchange may also list Quarterly Options Series on any options classes that are selected by other securities exchanges that employ a similar pilot program under their respective rules. The one-year pilot will commence the day the Exchange first initiates trading in a Quarterly Options Series, which shall be no later than July 24, 2006.

(a) The Exchange will list series that expire at the end of the next consecutive four (4) calendar quarters, as well as the fourth quarter of the next calendar year. For example, if the Exchange is trading Quarterly Options Series in the month of May 2006, it will list series that expire at the end of the second, third and fourth quarters of 2006, as well as the first and fourth quarters of 2007. Following the second quarter 2006 expiration, the Exchange will add series that expire at the end of the second quarter of 2007.

(b) The Exchange will not list a Short Term Option Series on an options class whose expiration coincides with that of a Quarterly Options Series on that same options class.

(c) Quarterly Options Series shall be P.M. settled.

(d) The strike price of each Quarterly Options Series will be fixed at a price per share, with at least two strike prices above and two strike prices below the value of the underlying security at about the time that a Quarterly Options Series is opened for trading on the Exchange. The Exchange may open for trading additional Quarterly Options Series of the same class if the current index value of the underlying index moves substantially from the exercise price of those Quarterly Options Series that already have been opened for trading on the Exchange. The exercise price of each Quarterly Options Series opened for trading on the Exchange shall be reasonably related to the current index value of the underlying index to which such series relates at or about the time such series of options is first opened for trading on the Exchange. The term “reasonably related to the current index value of the underlying index” means that the exercise price is within thirty percent (30%) of the current index value. The Exchange may also open for trading additional Quarterly Options Series that are more than thirty percent (30%) away from the current index value, provided that demonstrated customer interest exists for such series, as expressed by institutional, corporate, or individual customers or their brokers. Market-makers trading for their own account shall not be considered when determining customer interest under this provision.

(e) The interval between strike prices on Quarterly Options Series shall be the same as the interval for strike prices for series in that same options class that expire in accordance with the normal monthly expiration cycle.

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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. 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 Exchange proposes to amend its rules to accommodate the listing of option series that would expire at the close of business on the last business day of a calendar quarter ("Quarterly Options Series"). Specifically, Quarterly Options Series could be opened in any approved option class⁴ on a business day ("Quarterly Options Opening Date") and would expire at the close of business on the last business day of a calendar quarter ("Quarterly Options Expiration Date"). Specifically, the Exchange would list series that expire at the end of the next four consecutive calendar quarters, as well as the fourth quarter of the next calendar year. For example, if the Exchange were trading Quarterly Options Series in the month of May 2006, it would list series that expire at the end of the second, third and fourth quarters of 2006, as well as the first and fourth quarters of 2007. Following the second quarter 2006 expiration, the Exchange would add series that expire at the end of the second quarter of 2007.

⁴ Quarterly Options Series may be opened in options on indexes or options on Exchange Traded Fund ("ETFs") that satisfy the applicable listing criteria under ISE rules.

Quarterly Options Series listed on currently approved option classes would be P.M. settled and, in all other respects, would settle in the same manner as do the monthly expiration series in the same option class.

The proposed rule change would allow the Exchange to open up to five currently listed option classes that are either index options or options on ETFs. The strike price for each series would be fixed at a price per share, with at least two strike prices above and two strike prices below the value of the underlying security at about the time that a Quarterly Options Series is opened for trading on the Exchange. The proposal would permit the Exchange to open for trading additional Quarterly Options Series of the same class if the current index value of the underlying index moves substantially from the exercise price of those Quarterly Options Series already opened for trading on the Exchange. The exercise price of each Quarterly Options Series opened for trading on the Exchange would be required to be reasonably related to the current index value of the underlying index to which such series relates at or about the time such series of options were first opened for trading on the Exchange. The term “reasonably related to the current index value of the underlying index” means that the exercise price is within thirty percent of the current index value. The Exchange would also be permitted to open for trading additional Quarterly Options Series that are more than thirty percent away from the current index value, provided that demonstrated customer interest exists for such series, as expressed by institutional, corporate, or individual customers or their brokers. Market-makers trading for their own account would not be considered when determining customer interest under this provision.

Because monthly option series expire on the third Friday of their expiration month, a Quarterly Options Series, which would expire on the last business day of the quarter, could never expire in the same week in which a monthly option series in the same class expires. The same,

however, is not the case for Short Term Option Series. Quarterly Options Series and Short Term Option Series on the same option class could potentially expire concurrently under the proposal.⁵ Therefore, to avoid any confusion in the marketplace, the proposal stipulates that the Exchange may not list a Short Term Option Series that expires at the end of the day on the same day as a Quarterly Options Series in the same option class expires. In other words, the proposed rules would not permit the Exchange to list a P.M.-settled Short Term Option Series on an ETF or an index that would expire on a Friday that is the last business day of a calendar quarter if a Quarterly Options Series on that ETF or index were scheduled to expire on that day.

However, the proposed rules would permit the Exchange to list an A.M.-settled Short Term Option Series and a P.M.-settled Quarterly Options Series in the same option class that both expire on the same day (i.e., on a Friday that is the last business day of the calendar quarter). The Exchange believes that the concurrent listing of an A.M.-settled Short Term Option Series and a P.M.-settled Quarterly Options Series on the same underlying ETF or index that expire on the same day would not tend to cause the same confusion as would P.M.-settled short term and quarterly series in the same option class, and would provide investors with an additional hedging mechanism.

Finally, the interval between strike prices on Quarterly Options Series would be the same as the interval for strike price for series in the same option class that expires in accordance with the normal monthly expiration cycles.

The Exchange believes that Quarterly Options Series would provide investors with a flexible and valuable tool to manage risk exposure, minimize capital outlays, and be more responsive to the timing of events affecting the securities that underlie options contracts. At the

⁵ The Exchange currently does not have any Short Term Option Series listed for trading.

same time, the Exchange is cognizant of the need to be cautious in introducing a product that can increase the number of outstanding strike prices. For that reason, the Exchange proposes to employ a limited pilot program (“Pilot Program”) for Quarterly Options Series. Under the terms of the Pilot Program, the Exchange could select up to five option classes on which Quarterly Options Series may be opened on any Quarterly Options Opening Date. The Exchange would also be allowed to list those Quarterly Options Series on any option class that is selected by another securities exchanges with a similar Pilot Program under its rules. The Exchange believes that limiting the number of option classes in which Quarterly Options Series may be opened would help to ensure that the addition of the new series through this Pilot Program would have only a negligible impact on the Exchange’s and Option Price Reporting Authority’s (“OPRA”) quoting capacity. Also, limiting the term of the Pilot Program for a period of one year will allow the Exchange and the Commission to determine whether the Pilot Program should be extended, expanded, and/or made permanent.

If the Exchange were to propose an extension or an expansion of the Pilot Program, or were the Exchange to propose to make the Pilot Program permanent, the Exchange would submit, along with any filing proposing such amendments to the Pilot Program, a Pilot Program Report (“Report”) that will provide an analysis of the Pilot Program covering the entire period during which the Pilot Program was in effect. The Report would include, at a minimum: (1) data and written analysis on the open interest and trading volume in the classes for which Quarterly Options Series were opened; (2) an assessment of the appropriateness of the option classes selected for the Pilot Program; (3) an assessment of the impact of the Pilot Program on the capacity on ISE, OPRA and on market data vendors (to the extent data from market data vendors is available); (4) any capacity problems or other problems that arose during the operation of the

Pilot Program and how ISE addressed such problems; (5) any complaints that ISE received during the operation of the Pilot Program and how ISE addressed them; and (6) any additional information that would assist the Commission in assessing the operation of the Pilot Program. The Exchange must submit the Report to the Commission at least sixty days prior to the expiration date of the Pilot Program.

Alternately, at the end of the Pilot Program, if the Exchange determines not to propose an extension or an expansion of the Pilot Program, or if the Commission determines not to extend or expand the Pilot Program, the Exchange would no longer list any additional Quarterly Options Series and would limit all existing open interest in Quarterly Options Series to closing transactions only.

Finally, the Exchange represents that it has the necessary systems capacity to support the new option series that would result from the introduction of Quarterly Options Series. The Exchange has provided to the Commission information in a confidential submission that supports its system capacity representations.

2. Statutory Basis

The Exchange believes that the introduction of Quarterly Options Series will attract order flow to the Exchange, increase the variety of listing options available to investors, and provide investors with a valuable hedging tool. Accordingly, the Exchange believes 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, in that it is designed to promote just and equitable principles of trade and, in general, to protect investors and the public interest.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule change would 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

The Exchange has not solicited comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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 such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization 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, 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-2006-24 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ISE-2006-24. 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-2006-24 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

Nancy M. Morris
Secretary

⁸ 17 CFR 200.30-3(a)(12).