

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-53921; File No. SR-ISE-2006-28)

June 1, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change to Extend the Pilot Period for Preferred Orders

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> notice is hereby given that on May 18, 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 and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis, for a pilot period through June 10, 2007.

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

The Exchange is proposing to extend the pilot program for Preferred Orders until June 10, 2007. The text of the proposed rule change is set forth below. Brackets indicate deletions; underlining indicates new text.

\* \* \* \* \*

**Rule 713. Priority of Quotes and Orders**

(a) through (f) no change.

**Supplementary Material to Rule 713**

.01 through .02 no change.

---

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

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

.03 Preferred Orders. For a pilot period ending [June 10, 2006] June 10, 2007, an Electronic Access Member may designate a “Preferred Market Maker” on orders it enters into the System (“Preferred Orders”).

(a) through (c) no change.

\* \* \* \* \*

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 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

According to the Exchange, the purpose of the proposed rule change is to extend, until June 10, 2007, the pilot period for preferred orders as provided in paragraph .03 of the Supplementary Material to ISE Rule 713. The proposal amends ISE’s procedure for allocating trades among market makers and non-customer orders under ISE Rule 713 to provide an enhanced allocation to a “Preferred Market Maker” when it is quoting at the national best bid or offer (“NBBO”). Specifically, under the proposal, an Electronic Access Member may designate any market maker appointed to an options class to be a Preferred Market Maker on orders it enters into the Exchange’s system (“Preferred Orders”). If the Preferred Market Maker is not quoting at the NBBO at the time the Preferred Order is received, the Exchange’s existing

allocation and execution procedures will be applied to the execution.<sup>3</sup> The proposed rule is subject to a pilot program that is currently set to expire on June 10, 2006.<sup>4</sup>

Under the proposal, if a Preferred Market Maker is quoting at the NBBO at the time a Preferred Order is received, the allocation procedure is modified so that the Preferred Market Maker (instead of the Primary Market Maker<sup>5</sup>) would receive an enhanced allocation equal to the greater of: (i) the proportion of the total size at the best price represented by the size of its quote; or (ii) sixty percent of the contracts to be allocated if there is only one other Non-Customer Order or market maker quotation at the best price and forty percent if there are two or more other Non-Customer Orders and/or market maker quotes at the best price.<sup>6</sup> Unexecuted contracts remaining after the Preferred Market Maker's allocation would be allocated pro-rata based on size as described above.

The Exchange believes the proposed rule change is a necessary competitive response to the preferencing rules adopted by other options exchanges and would help the ISE attract and retain order flow. The Exchange believes that this order flow would add depth and liquidity to the Exchange's markets and enable the Exchange to continue to compete effectively with other options exchanges.

---

<sup>3</sup> Marketable customer orders are not automatically executed at prices inferior to the NBBO. If the ISE best bid or offer is inferior to the NBBO, it is handled by the Primary Market Maker according to ISE Rule 803(c).

<sup>4</sup> See Securities Exchange Act Release No. 52066 (July 20, 2005), 70 FR 43479 (July 27, 2005).

<sup>5</sup> A Primary Market Maker may be the Preferred Market Maker, in which case such market maker would receive the enhanced allocation for Preferred Market Makers.

<sup>6</sup> All allocations are automatically performed by the Exchange's system.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>8</sup> in particular, in that the proposed rule change is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, to protect investors and the public interest. The Exchange also believes that extension of the pilot program would allow the Exchange and the Commission to evaluate the rule change over an additional one-year period.

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

The Exchange believes that the proposed rule change does not 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, and does not intend to solicit comments on 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 and whether the pilot time frame is appropriate. Comments may be submitted by any of the following methods:

---

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 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](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2006-28 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-ISE-2006-28. 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-2006-28 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 the Proposed Rule Change

The Exchange has asked the Commission to approve the proposed rule change on an accelerated basis for an additional year in order to avoid disruption in the operation of the market. After careful consideration, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act<sup>9</sup> and the rules and regulations thereunder applicable to a national securities exchange<sup>10</sup>, and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>11</sup> Section 6(b)(5) requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, 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, in general, to protect investors and the public interest. The Commission notes that the current pilot was approved for a total of one year<sup>12</sup> to give the Commission an opportunity to evaluate the impact of the pilot program on the options markets to determine whether it would be beneficial to customers and to the options markets as a whole before approving any request for permanent approval of the pilot program. The Commission believes that a one-year extension of the pilot period would provide

---

<sup>9</sup> 15 U.S.C. 78f.

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

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

<sup>12</sup> The Commission initially approved the Exchange's Preferred Order program on a six week pilot basis while the Commission sought comment on the proposed rule change. See Securities Exchange Act Release No. 51818 (June 10, 2006), 70 FR 35146 (June 16, 2006). The Commission subsequently extended to the pilot period until June 10, 2006, which was one year from the date the Commission first approved the Exchange's Preferred Order program on a pilot basis. See Securities Exchange Act Release No. 52066 (July 20, 2005), 70 FR 43479 (July 27, 2005).

the Commission with additional time to continue evaluate the Exchange's Preferred Order program.

The Exchange has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register. The Commission believes that granting accelerated approval of the proposed rule change would allow the pilot program to continue without disruption while the Commission and the Exchange continue to review the pilot program's impact on the options market. Accordingly, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,<sup>13</sup> for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register.

---

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

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-ISE-2006-28), which institutes the pilot program through June 10, 2007, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

Nancy M. Morris  
Secretary

---

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</sup> 17 CFR 200.30-3(a)(12).