

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54228; File No. SR-ISE-2006-14)

July 27, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 Thereto Relating to ISE Rule 720

I. Introduction

On March 22, 2006, the International Securities Exchange, Inc. (“ISE” or “Exchange”) 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 720 (the “Obvious Error Rule”). On May 18, 2006, the ISE submitted Amendment No. 1 to the proposed rule change.³ The proposed rule change and Amendment No. 1 were published for comment in the Federal Register on June 14, 2006.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

II. Description

The ISE proposes to amend ISE Rule 720 to provide that, unless all parties to a trade agree otherwise, the Exchange (through its Market Control Unit) may nullify a transaction if all

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange amended proposed new Supplementary Material .08 to ISE Rule 720 to state that unless all parties to a trade agree otherwise, ISE Market Control may nullify a trade if all parties to a trade fail to receive a trade execution report due to a verifiable system outage. Amendment No. 1 also clarified that the proposed rule change operates under the assumption that a trade has taken place, but due to a system outage, the parties to the trade never received a trade execution report and thus were unaware of the trade having taken place.

⁴ See Securities Exchange Act Release No. 53948 (June 6, 2006), 71 FR 34407.

parties to the trade do not receive a trade execution report⁵ due to a verifiable system outage.

The Exchange represented that it routinely sends out trade execution reports to all Members that are parties to a trade.⁶

The ISE states that it developed the Obvious Error Rule to address the need to handle errors in a fully electronic market where orders and quotes are executed automatically before an obvious error may be discovered and corrected by Members. The Exchange notes that in formulating the Obvious Error Rule, it weighed carefully the need to assure that one market participant is not permitted to receive a windfall at the expense of another market participant that made an obvious error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange believes that the proposed rule change would strengthen ISE's Obvious Error Rule because it would ensure that parties are not adversely affected by a trade whose terms were never fully communicated to them as a result of a system outage. As a matter of "housekeeping," the Exchange also proposes to renumber ISE Rule 720(e) as ISE Rule 720(d).

III. Discussion

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 exchange⁷

⁵ A trade execution report is an ISE system message sent to all parties to a trade to inform them that a trade has been consummated. Among other things, a trade execution report contains pertinent details such as the underlying security, the price, number of contracts traded, the strike price and the expiration date.

⁶ See, Amendment No. 1, supra note 3.

⁷ 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).

and, in particular, the requirements of Section 6(b) of the Act⁸ and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,⁹ in that it designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities, 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 Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the circumstances surrounding an execution suggest that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred should be based on specific and objective criteria and subject to specific and objective procedures. Under ISE's proposal, unless all parties to a trade agree otherwise, ISE Market Control may nullify a trade if all parties to the trade fail to receive a trade execution report due to a verifiable system outage. The Commission believes that ISE's proposal provides specific and objective criteria to be used by the Exchange to nullify a trade in this circumstance. Accordingly, the Commission finds that the Exchange's proposal is consistent with the Act.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-ISE-2006-14), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Nancy M. Morris
Secretary

¹⁰ 15 U.S.C. 78f(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).