

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54287; File No. SR-ISE-2006-48)

August 8, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to the Adoption of Rules to Govern its Electronic Trading System for Equities

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 August 4, 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 prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The ISE proposes to adopt rules and amend existing ISE rules to govern its new electronic trading system for equities, the ISE Stock Exchange, LLC (“ISE Stock Exchange”), which will be an equity exchange facility of the ISE. In addition, the ISE proposes to apply certain of its options rules to the trading of equity securities on the ISE Stock Exchange. The proposed rules address the electronic trading of equities under Regulation NMS under the Act, and the rules and regulations thereunder. The text of the proposed rules is available on the Commission’s Web site at www.sec.gov (under Self-Regulatory Organization Rulemaking and National Market System Plans), on the ISE Web site at www.iseoptions.com, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

Background

The Exchange is proposing to adopt a series of rules in connection with its ISE Stock Exchange. The ISE Stock Exchange consists of a new electronic trading system developed to trade equities ("System"), which will be a facility of the ISE. The System will provide for the electronic execution and display of orders as well as a midpoint matching system. The class of members who will be eligible to trade on the ISE Stock Exchange are electronic access members ("EAMs") that the ISE specifically authorizes to trade in the System ("Equity EAMs"). Orders will be ranked in price-time priority regardless of the identity of the entering Equity EAM. Executions on the ISE Stock Exchange will take place automatically and immediately upon order entry if trading interest is available. The System will provide a routing service for orders when trading interest is not present on the ISE Stock Exchange. The ISE Stock Exchange will not have any market makers, only Equity EAMs who will provide liquidity to the Exchange. The ISE Stock Exchange will be an order-driven marketplace. There will be no market makers that are required to provide quotes.

The proposed rules incorporate the trade-through rule of Regulation NMS³ by requiring that, for any execution to occur on the Exchange during regular trading hours,⁴ the price must be equal to, or better than, any “protected quotation” within the meaning of Regulation NMS (“Protected Bid or Protected Offer”), unless an exception to Rule 611 of Regulation NMS is available.⁵ ISE Stock Exchange proposes to direct to away markets for execution all or a portion of the orders that cannot be executed at the Protected Bid or Protected Offer on the Exchange.⁶

The Exchange previously filed with the Commission pursuant to Rule 19b-5 under the Act a Form PILOT to commence operation of the Exchange’s MidPoint Match System.⁷ Included within the Form PILOT filing are rules governing trading in the MidPoint Match System. The rules filed under Form PILOT, which have not been approved by the Commission, are included in this filing for Commission approval.

The Exchange has filed with the Commission pursuant to Rule 19b-4 under the Act a proposed rule change to establish the ISE Stock Exchange, LLC as a facility (as defined in Section 3(a)(2) of the Act)⁸ of the Exchange.⁹

³ 17 CFR 242.611.

⁴ The hours of business during which transactions may be made on the ISE Stock Exchange are set forth in proposed ISE Rule 2102 and are referred to herein as “regular trading hours.”

⁵ See proposed ISE Rule 2107(c).

⁶ See proposed ISE Rule 2107(d).

⁷ See Form PILOT ISE-2006-01 (July 28, 2006).

⁸ 15 U.S.C. 78c(a)(2).

⁹ See Securities Exchange Act Release No. 54273 (August 3, 2006) (SR-ISE-2006-46).

Trading Rules

The ISE proposes to adopt new Chapter 21, which will be added to the Exchange's Rules, and to amend other rules to accommodate the proposed new System. Although certain aspects of the Exchange's Rules are incorporated by reference, as noted below, the majority of the rules contained in proposed Chapter 21 are new.

Operating Hours. Proposed ISE Rule 2102 provides for the ISE Stock Exchange to operate during regular trading hours. Specifically, the System will accept orders each day prior to the opening. ISE Stock Exchange will open for trading each day for NYSE and Amex securities once the primary market in that security opens on a primary trade followed by a NBBO quote.¹⁰ The ISE Stock Exchange will open for trading each day for Nasdaq securities with the first received NBBO after 9:30 a.m. The ISE Stock Exchange will close at the same time as the close of the regular trading session on the primary market.

Opening. ISE Stock Exchange will open based upon the opening of the primary market for a security. When the primary market is either the NYSE or the Amex, the opening trade will be executed at the midpoint of the first reported NBBO subsequent to a reported trade on the primary market. When the primary market is Nasdaq, the opening trade will be executed at the midpoint of the first reported NBBO. All orders eligible to trade at the midpoint will be processed in time sequence, beginning with the oldest order. Matches will occur until there is no remaining volume or there is an imbalance of orders. Following the opening execution process in an individual security, all orders remaining will be executed in accordance with the proposed

¹⁰ Proposed ISE Rule 2106(c) defines the primary market as the listing market for a security. If a security is traded on both the NYSE and the Amex, the primary market would be considered the NYSE. If a security is listed on both the NYSE and Nasdaq, the NYSE would be considered the primary market.

ISE Rules, discussed in more detail below. All other orders will be displayed on the order book, canceled, or routed to other Trading Centers in accordance with proposed ISE Rule 2107(d).

Re-openings will be handled in the same manner as the opening, as discussed above.

Regular Trading Session. Once the opening occurs for individual securities, ISE Stock Exchange will operate during regular trading hours. All displayed orders will be automatically matched following price and time priority as soon as they are entered in the order book. Except as provided below, incoming orders will be executed at or within the NBBO.

Closing. The ISE Stock Exchange will cease accepting and executing orders at the time the primary market closes.

Newly Defined Terms. The Exchange is proposing to adopt new terms as part of proposed Chapter 21 to accommodate the trading of equities under Regulation NMS. In addition to the adoption of general terms governing equity trading, the Exchange proposes to adopt terms specific to Regulation NMS and trading thereunder.¹¹ Specifically, the Exchange is proposing to adopt the following definitions, each of which has the same meaning as contained in Regulation NMS: “Automated Quotation,” “Automated Trading Center,” “Manual Quotation,” “Protected Bid or Protected Offer,” “Protected Quotation,” “Trade-Through,” and “Trading Center.”

Eligible Securities and Eligible Orders. As set forth in proposed ISE Rule 2101(a), the ISE Stock Exchange will trade equity securities only pursuant to unlisted trading privileges (“UTP”). While the proposed rules would allow the ISE Stock Exchange to trade common stock, Commodity-Based Trust Shares, Currency Trust Shares, Partnership Units, Trust Issued

¹¹ See proposed ISE Rule 2100(c).

Receipts including those based on Investment Shares, and Investment Company Units by either listing and/or trading pursuant to UTP, in order to list equity securities on the Exchange, the Exchange would first need to seek Commission approval and amend its rules to comply with Rule 10A-3 under the Act and to incorporate qualitative listing criteria.

For orders entered into the ISE Stock Exchange, the minimum price variation (“MPV”) is \$0.01, with the exception of securities that are priced less than \$1.00 for which the MPV for order entry is \$0.0001.¹²

The System will not execute odd lot orders. The System will accept round lot orders and partial round lot (“PRL”) orders for execution. Round lot orders will be executed in full when contra side interest is present. The round lot portions of a PRL order will be executed when contra side interest is present; the odd lot portion of the PRL order will be cancelled upon completion of the last round lot execution of the PRL order.

To be eligible to enter routable orders into the ISE Stock Exchange, Equity EAMs must, among other things, enter into a routing agreement with the Outbound Routing Facility, as described below.¹³ Despite the existence of a routing agreement, if Equity EAMs do not want certain orders routed to away Trading Centers, they may prohibit routing by entering orders that are not eligible for routing by virtue of the order type, as discussed below.

¹² The Exchange has committed to amend its proposed MPV rule to conform with the language of Rule 612 of Regulation NMS under the Act. The amended rule would read as follows: “The minimum price variation (“MPV”) for bids, offers, and orders that are displayed, ranked or accepted on the ISE Stock Exchange is \$0.01, with the exception of bids, offers, and orders that are priced less than \$1.00, for which the MPV is \$0.0001.” Telephone conversation between Laura Clare, Assistant General Counsel, ISE, and Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, on August 7, 2006.

¹³ See proposed ISE Rule 2105(d).

The following order types are eligible for execution on the ISE Stock Exchange:¹⁴

The ISE Stock Exchange will accept Market Orders. A Market Order is an order to buy or sell a stated amount of a security that is to be executed immediately and automatically at the best available price(s) when the order reaches the ISE Stock Exchange to the greatest extent possible without causing a Trade-Through. Any unexecuted shares of a Market Order may be routed in whole or in part to other Trading Centers with Protected Quotations.

The ISE Stock Exchange will accept a number of types of limited priced orders. The System will accept Limit Orders. Limit Orders are one-sided orders to buy or sell a stated quantity of a security at a specified price or better. The System will also accept Reserve Orders. Reserve Orders are limit orders with a portion of the size that is to be displayed and a reserve portion of the size at the same price that is not to be displayed, but is to be used to refresh the displayed size when the displayed size is executed in full. Limit Orders and Reserve Orders will be routable unless otherwise marked as discussed below by an Equity EAM.

Other limited-price orders include Fill-or-Kill (“FOK”) Orders, Immediate-or-Cancel (“IOC”) Orders and Intermarket Sweep Orders (“ISO”). IOC Orders are executed immediately and automatically against existing orders on the System to the greatest extent possible without causing a Trade-Through, and any unexecuted balance will be canceled. Any Equity EAM may use an IOC Order to immediately and automatically execute against the full size of the displayed quotation on the System (including any undisplayed or reserve size available at the price of the displayed quotation). As with all executions on the ISE Stock Exchange, the System will immediately and automatically transmit a response to the Equity EAM who sent the IOC Order

¹⁴ See proposed ISE Rule 2104.

indicating the action taken with respect to the IOC Order. Additionally, the System will immediately and automatically update its quotation as a result of the execution.

ISOs are executed immediately and automatically against existing orders on the System at their executable price, in order of their ranking, and the shares of the ISO not so executed will be cancelled.¹⁵ An ISO will be executed on the ISE Stock Exchange without regard to any Protected Quotations.

The System will accept the following orders to be handled on the ISE Stock Exchange, without routing to another Trading Center: IOC Order, FOK Order, Not Routable Order and Post Only Order.¹⁶ FOK Orders are to be executed in their entirety or cancelled upon receipt. Not Routable Orders are limit orders that are to be executed in whole or in part upon receipt, and if not fully executed, displayed on the ISE Stock Exchange, as long as the order would not be executable against a Protected Quotation.¹⁷ Post Only Orders are limit orders that are to be displayed on the ISE Stock Exchange upon receipt or cancelled if they are executable upon entry, either on the ISE Stock Exchange or at another Trading Center.

The System also will accept Pegged Orders.¹⁸ Pegged Orders are limit orders to buy or sell a stated amount of a security at a displayed price set to track the current NBBO. The tracking of the relevant NBBO for Pegged Orders will occur on a real-time basis. If the calculated price for the Pegged Order would exceed its limit price, it will no longer track and will remain displayed at its limit price.

¹⁵ The ISE Stock Exchange intends the ISO Order to be equivalent to the Intermarket Sweep Order defined in Rule 600(b)(30) of Regulation NMS under the Act.

¹⁶ See proposed ISE Rules 2107(b)(2)(i), (ii), (iii), (iv), respectively.

¹⁷ See proposed ISE Rule 2112.

¹⁸ See proposed ISE Rule 2104(j).

The System will accept Midpoint Match (“MPM”) Orders.¹⁹ MPM Orders are unpriced orders to buy or sell a stated quantity of an Equity Security at the midpoint of the NBBO. A MPM Order may be entered with a boundary price, and the System will not execute such order outside of the boundary price. Any boundary price must be in whole penny increments.

Order Routing. When the ISE Stock Exchange does not have interest at the NBBO, it will offer a routing service for Equity EAMs. Certain order types, including Market Orders and Limit Orders, are eligible to be routed.²⁰

Market Orders and Limit Orders Executable on the ISE Stock Exchange. An IOC or ISO will automatically be sent to one or more Trading Centers with a Protected Bid or Protected Offer that is better than the ISE Stock Exchange quote for the lesser of the full displayed size of the Protected Bid or Protected Offer or the balance of the order. Any additional balance of the order will be executed on the ISE Stock Exchange simultaneously. If the market is crossed, the order may be executed as described below.

Limit Orders Unexecutable on the ISE Stock Exchange. If display of a limit order (or any balance thereof) on the ISE Stock Exchange would lock or cross a Protected Bid or Protected Offer, an ISO order will automatically be sent to one or more Trading Centers with a Protected Bid or Protected Offer that would be locked or crossed by the display of the order for up to the full displayed size of the Protected Bid or Protected Offer. Any additional balance of the order will be displayed on the ISE Stock Exchange immediately.

¹⁹ See proposed ISE Rule 2128.

²⁰ See proposed ISE Rule 2107(d).

Market Orders Unexecutable on the ISE Stock Exchange. An IOC will automatically be sent to one or more Trading Centers with a Protected Bid or Protected Offer for the full size of the market order that is not executable on the ISE Stock Exchange.

The following order types are, by their terms, never routed: FOK Orders, IOC Orders, MPM Orders, Not Routable, and Post Only. The System will not route orders to away quotations that are not Protected Quotations, unless required by ISE Rules. Additionally, the System may trade through the price of away quotations that are not Protected Quotations.

Priority of Orders. The ISE Stock Exchange will rank displayed orders on the System in strict price-time priority.²¹ Orders are ranked beginning with the highest priced orders to buy and the lowest priced orders to sell. For the purposes of ranking, the System uses the price at which the order is displayed.²² Within each price, orders are ranked in time priority based on the time that an order is displayed or “updated” at that price, except that the undisplayed portion of the Reserve Orders will be ranked after all other orders and displayed portions of Reserve Orders at the same price. Orders that are updated or changed are ranked based on the time of change.

Anonymity. Except as provided below, transactions executed on the ISE Stock Exchange will be processed anonymously.²³ This means that the ISE Stock Exchange

²¹ See proposed ISE Rule 2107.

²² According to the Exchange, Equity EAMs can choose to place orders into MPM or into the displayed market. Orders placed into the displayed market will be eligible, by default, to interact with MPM Orders for purposes of gaining price improvement. Optionally, orders in the displayed market can bypass MPM by being marked as No MPM. The Exchange represented that it will amend the proposed rule change to set forth more clearly how orders entered into the displayed market would interact with MPM Orders. Telephone conversation among Laura Clare, Assistant General Counsel, and Robert Books, ISE, and Nancy Sanow, Assistant Director, and David Orlic, Special Counsel, Division of Market Regulation, Commission, on August 8, 2006.

²³ See proposed ISE Rule 2117.

transaction reports will indicate the details of the transaction, but will not reveal contra party identities.²⁴ The Exchange believes that post trade anonymity should benefit investors because preserving anonymity until and after the settlement of a trade should limit the potential market impact that disclosing the Equity EAMs identity may have. Specifically, when contra party identity is revealed, Equity EAMs may be able to detect trading patterns and make assumptions about the potential direction of the market based on the Equity EAM's presumed client base. For example, if the Equity EAM handles large institutional orders and becomes an active buyer in a security, others could anticipate such demand and adjust their trading strategy accordingly. The Exchange believes that this could result in increased costs. The Exchange believes that post-trade anonymity should not compromise an Equity EAM's ability to settle an erroneous trade, because under proposed ISE Rule 2127, the clearly erroneous execution resolution process is coordinated by the Exchange, without the need for contra parties to know each other's

²⁴ The ISE has submitted a request for a limited exemption from paragraph (a)(2)(i)(A) of Rule 10b-10 under the Act on behalf of Equity EAMs that execute trades on the ISE for their customers and a request for no-action relief with respect to the corresponding books and records requirements of Rules 17a-3 and 17a-4 under the Act. Rule 10b-10, among other things, requires a broker-dealer to disclose to its customers the identity of the party the broker-dealer sold to, or bought from, to fill the customer's order. The ISE Stock Exchange will not routinely reveal the identity of the actual contra-party when the order is executed against another ISE Equity EAM. Therefore, the Equity EAMs will not be able to comply with the contra-party identification requirement of Rule 10b-10. To permit Equity EAMs to utilize the ISE Stock Exchange without violating Rule 10b-10, the Exchange is seeking an exemption, on behalf of such Equity EAMs from the contra-party identification requirement. Additionally, the Exchange has asked the Commission not to recommend enforcement action for violations of the corresponding books and records requirements of Rules 17a-3 and 17a-4 if, in lieu of making and preserving a separate record, a broker-dealer relies on the Exchange's retention of the identities of Equity EAMs that execute anonymous trades on the ISE Stock Exchange.

identities. By masking the Equity EAM's identity, the Exchange believes it may help Equity EAMs meet their best execution obligations by mitigating market impact.²⁵

The Exchange only will reveal the identity of the Equity EAM or the Equity EAM's clearing firm in the following circumstances: (1) for regulatory purposes or to comply with an order of a court or arbitrator; (2) when the National Securities Clearing Corporation ("NSCC") ceases to act for the Equity EAM or the Equity EAM's clearing firm and NSCC determines not to guarantee the settlement of the Equity EAM's trades; or (3) on risk management reports provided to the contra party of the Equity EAM or Equity EAM's clearing firm each day after 4:00 p.m. that discloses trading activity on an aggregate dollar value basis. Also, the Exchange will reveal to an Equity EAM, no later than the end of the day on the date an anonymous trade was executed, when that Equity EAM submits an order that has executed against an order submitted by that same Equity EAM.²⁶

To satisfy the Equity EAM's recordkeeping obligations under Rules 17a-3(a)(1)²⁷ and 17a-4(a) under the Act,²⁸ the ISE Stock Exchange will, with the exception of those circumstances described below, retain for the period specified in Rule 17a-4(a) the identity of each Equity EAM that executes an anonymous transaction. In addition, Equity EAMs will retain the obligation to comply with Rules 17a-3(a)(1) and 17a-4(a) whenever they possess the identity

²⁵ See Securities Exchange Act Release No. 49053 (January 12, 2004), 69 FR 2642, (January 16, 2004) (SR-PCX-2003-63) (notice of filing and immediate effectiveness of proposed rule change by the Pacific Exchange, Inc. relating to post-trade anonymity to its ETP Holders).

²⁶ See proposed ISE Rule 2117(d) and (e).

²⁷ 17 CFR 240.17a-3(a)(1).

²⁸ 17 CFR 240.17a-4(a).

of their contra party. In either case, the information will be retained in its original form or a form approved under Rule 17a-6 under the Act.²⁹

Prevention of Trade-Throughs. The System is designed to automatically prevent trade-throughs of Protected Quotations. The System will accomplish this in two principal ways: (1) through the use of outbound routing for those orders that will be available to route; and (2) by displaying orders at prices that would not cause a trade-through when executed. Additionally, the System will take advantage of various exceptions to Rule 611 of Regulation NMS under the Act.³⁰ The Exchange has proposed to adopt an exception (“self-help”) to allow for the System to trade-through a Protected Quotation displayed by a Trading Center that is experiencing a failure, material delay, or malfunction of its systems or equipment. The System may bypass those Protected Quotations by: (1) notifying the non-responding Trading Center immediately after (or at the same time as) electing self-help; and (2) assessing whether the cause of the problem lies with its own systems and, if so, taking immediate steps to resolve the problem. ISOs may, by definition, trade-through Protected Quotations when the System has simultaneously routed an intermarket sweep order to execute against the full displayed size of that Protected Quotation. Additionally, transactions executed while the Protected Quotations are crossed are permissible.

Locked and Crossed Markets. The ISE Stock Exchange will not intentionally lock or cross any away Protected Quotations on another Trading Center,³¹ except in certain circumstances. For instance, the System may lock or cross an away Protected Quotation:

²⁹ 17 CFR 240.17a-6.

³⁰ See proposed ISE Rule 2107(c).

³¹ See proposed ISE Rule 2112.

(1) when a Protected Bid is higher than a Protected Offer or (2) if the System has first routed an order to that quotation and all better priced quotations for their full displayed size.

Clearly Erroneous Executions. Pursuant to proposed ISE Rule 2127, an Equity EAM that receives an execution on an order that was submitted erroneously to the ISE Stock Exchange for its own or customer account may request that the Market Control, along with a member of the regulatory staff, review the transaction under ISE Rule 2127(b) within the time limits described therein. Market Control will review the transaction with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. A member of the regulatory staff will advise and participate in all steps of Market Control's review of the transaction. Based upon this review, Market Control will decline to "break" a disputed transaction if Market Control believes that the transaction under dispute is not clearly erroneous. However, if Market Control determines the transaction in dispute is clearly erroneous, Market Control will declare that the transaction is null and void or modify one or more terms of the transaction. When adjusting the terms of a transaction, Market Control will seek to adjust the price and/or size of the transaction to achieve an equitable rectification of the error that would place the parties to a transaction in the same position, or as close as possible to the same position, as they would have been in had the error not occurred. For purposes of the clearly erroneous rule, the terms of a transaction are "clearly erroneous" when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.

Market Control may, on its own motion, review transactions on the ISE Stock Exchange that arose during any disruption or malfunction in the use or operation of any electronic communications or trading facilities of the ISE Stock Exchange, or extraordinary market

conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest. Each Equity EAM will be notified as soon as practicable, and the Equity EAM aggrieved by the action may appeal such action to the Trade Panel.

Access to the ISE Stock Exchange. The class of members who will be eligible to trade on the ISE Stock Exchange are Equity EAMs. There are no differences in access offered to different classes of members. However, only Equity EAMs that use the Financial Information Exchange (“FIX”) Protocol – as opposed to the Common Message Switch (“CMS”) Protocol – will be able to receive information regarding Solicitations of Interest, as discussed below.

All current EAMs are eligible to become Equity EAMs. They will need to certify that they have operational connectivity to the System. In addition, they will have to pay any standard ISE Stock Exchange access fees. Any broker-dealer that is not currently an EAM can become an Equity EAM first by applying for EAM status through the existing membership process and then by connecting to the ISE Stock Exchange and paying any applicable fees. Such fees will be the same for current and new EAMs seeking to become Equity EAMs. All Equity EAMs also will need the ability to clear ISE Stock trades at DTCC, either by self-clearing or through the use of a DTCC member.

Outbound Routing Facility. In connection with the proposed changes to the trading rules described above, the Exchange intends to have a contractual relationship with a broker-dealer that will function solely as the outbound routing facility (“ORF”) of the Exchange.³² ORF

³² ORF is engaged solely in the business of acting as a routing agent. Telephone conversation between Laura Clare, Assistant General Counsel, ISE, and Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, on August 7, 2006.

will be both a member of the NASD and the ISE. ORF will provide an optional routing service for the Exchange, in which ORF will route orders from the Exchange to Trading Centers with Protected Quotations or, when required, Manual Quotations through other brokers (“Access Brokers”) that are members or participants of those Trading Centers. As an Outbound Router, ORF will receive routing instructions from the System, route orders to another Trading Center through an Access Broker and be responsible for reporting resulting executions back to the System, which in turn will report resulting executions back to the Equity EAM. All orders routed through ORF will be subject to the Exchange’s rules. Use of the ORF is optional for Equity EAMs, as discussed above.

The Outbound Router function of ORF will operate as a facility (as defined in Section 3(a)(2) of the Act) of the Exchange.³³ As such, the Outbound Router function of ORF is subject to the Commission’s continuing oversight. In particular, and without limitation, under the Act, the Exchange is responsible for filing with the Commission proposed rule changes and fees relating to the ORF Outbound Router function, and ORF is subject to exchange non-discrimination requirements.³⁴

Pursuant to Rule 17d-1 under the Act,³⁵ where a member of the Securities Investor Protection Corporation is a member of more than one self-regulatory organization (“SRO”), the Commission will designate to one of such organizations the responsibility for examining such member for compliance with the applicable financial responsibility rules.³⁶ The SRO

³³ 15 U.S.C. 78c(a)(2).

³⁴ 15 U.S.C. 78f(b)(6).

³⁵ 17 CFR 240.17d-1.

³⁶ Pursuant to Rule 17d-1 under the Act, in making such designation the Commission will take into consideration the regulatory capabilities and procedures of the SROs,

designation by the Commission is referred to as a “Designated Examining Authority” (“DEA”). As noted above, ORF will apply to become a member organization of the Exchange, and a member of the NASD. The NASD is an SRO not affiliated with the Exchange or its affiliates and is a DEA pursuant to Rule 17d-1 under the Act.³⁷ The Exchange will also enter into a 17d-2 Agreement with the NASD to delegate to the NASD all regulatory oversight and enforcement responsibilities with respect to ORF pursuant to applicable laws.

The Exchange will establish and maintain procedures and internal controls to restrict the flow of confidential and proprietary information between the Exchange and its ORF and any other entity or affiliate of the ORF.³⁸ The books, records, premises, officers, directors, agents, and employees of the ORF, as a facility of the Exchange, shall be deemed to be the books, records, premises, officers, directors, agents, and employees of the Exchange for purposes of and subject to oversight pursuant to the Act. The books and records of the ORF, as a facility of the Exchange, shall be subject at all times to inspection and copying by the Exchange and the Commission.

MidPoint Match. The MidPoint Match System is a mechanism of the ISE Stock Exchange for trading common stocks and similar securities in a continuous mid-point matching system.³⁹ Equity EAMs will be able to enter unpriced orders into the MidPoint Match System.⁴⁰

availability of staff, convenience of location, unnecessary regulatory duplication, and such other factors as the Commission may consider germane to the protection of investors, the cooperation and coordination among SROs, and the development of a national market system for the clearance and settlement of securities transactions.

³⁷ 17 CFR 240.17d-1.

³⁸ See proposed ISE Rule 2108.

³⁹ See proposed ISE Rule 2128.

In entering an order, a member must specify: the security; whether it is a buy or sell order; and the number of shares the member seeks to buy or sell. Although unpriced, members also may specify a boundary price above which they will not buy (or below which they will not sell). The System will continuously monitor buy and sell orders in the System and will execute orders at the mid-point of the NBBO as long as the execution does not violate the boundary price on an order.

When entering an order, a member can specify what, if any, information the system should disseminate:

- (1) The member can specify that the system not disseminate any information regarding the order (“Standard Order”); or
- (2) The member can specify that the system disseminate that there is a pending order in a particular security, but without identifying whether it is a buy or sell order (a “Solicitation of Interest” or “SOI”).

The System will reject an SOI (but not a Standard Order) with a boundary price that is not then currently executable. Upon arrival of an SOI, the System will immediately generate a single broadcast internally to all Equity EAMs that have programmed to accept this message announcing the arrival of the order. An Equity EAM entering an SOI may not cancel that SOI for five seconds. In addition, if an SOI is not executed within ten seconds, the SOI will convert into a Standard Order.

Because MPM will execute all trades at the mid-point of the NBBO, the MidPoint Match System never will execute a trade outside of the NBBO. In addition, the system will not execute

⁴⁰ See supra note 22 regarding interaction of orders entered into the displayed market with MPM Orders.

a trade if the quotation for a security is “crossed,” with the best national bid being greater than the best national offer; in that situation, the system will suspend executions, since both buyers and sellers may be able to receive executions in other markets at prices better than the NBBO midpoint. If the quotation is “locked,” with the best national bid equaling the best national offer, the system will execute all trades at the locked price.

Other Rule Changes. Proposed Rules 2122 (Investment Company Unit), 2123 (Trust Issued Receipts), 2124 (Commodity-Based Trust Shares), 2125 (Currency Trust Shares), and 2126 (Partnership Units) are proposed rules to permit the trading of derivative products on the ISE Stock Exchange. While these proposed rules would allow the ISE Stock Exchange to trade Commodity-Based Trust Shares, Currency Trust Shares, Partnership Units, Trust Issued Receipts including those based on Investment Shares, and Investment Company Units by either listing and/or trading pursuant to UTP, the Exchange will only trade these products pursuant to UTP. In order to list such products on the Exchange, the Exchange would first need to seek Commission approval and amend its applicable rules.

Proposed ISE Rule 2117 (Settlement Through Clearing Corporations) adds provisions governing the settlement and clearing of equities.

Proposed ISE Rules 2113 (Long and Short Sales) and 2114 (Doing Business With the Public) have been filed separately.⁴¹

The following Rules have been incorporated from the Exchange’s options rules: ISE Rule 100 (Definitions) is being expanded to include equities in the following definitions: bid, clearing corporation, offer and order; ISE Rule 500 (Designation of Securities) is being amended

⁴¹ See File Nos. SR-ISE-2006-42 (filed on July 25, 2006) and SR-ISE-2006-41 (filed on July 25, 2006), respectively.

to accommodate for the newly adopted rules in Chapter 21; ISE Rules 702 and 703 (Trading Halts and Trading Halts Due to Extraordinary Market Volatility, respectively) are being amended to account for halting trading in equity securities. In addition, the Exchange proposes to apply certain of its options rules to the trading of equity securities on the ISE Stock Exchange, as set forth in Appendix A to proposed Chapter 21 of the ISE Rules.

2. Statutory Basis

ISE believes the proposal is consistent with the requirements of the Act and the rules and regulations promulgated thereunder that are applicable to a national securities exchange, and in particular, with Section 6(b) of the Act.⁴² ISE believes that the proposal is consistent with Section 6(b)(5) of the Act,⁴³ in that it is 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest. In particular, the ISE believes that the proposal is designed to enable it to promote competition in the trading of equity securities through establishing a new marketplace.

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

The Exchange does not believe that the proposed rule change will 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

⁴² 15 U.S.C. 78f(b).

⁴³ 15 U.S.C. 78f(b)(5).

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments on this proposal from members, participants, or others.

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 Exchange consents, the Commission will:

- A. by order approve the 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 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-2006-48 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-2006-48. 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 the 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-2006-48 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.⁴⁴

Nancy M. Morris
Secretary

⁴⁴ 17 CFR 200.30-3(a)(12).