

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56306; File No. SR-ISE-2007-74)

August 22, 2007

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Relating to an Extension of the Penny Pilot Program

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 21, 2007, the International Securities Exchange, LLC (“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 ISE. On August 22, 2007, the Exchange filed Amendment No. 1 to the proposed rule change. 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 is proposing to expand a pilot program to quote and trade certain options in pennies. The text of the proposed rule change is available at <http://www.ise.com>, at the Exchange, and at the Commission’s Public Reference Room.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

On January 24, 2007, the Commission approved ISE's rule filing, SR-ISE-2006-62, which allowed 13 option classes to quote in penny increments in connection with the implementation of an industry-wide, six month pilot program (the "Penny Pilot Program").³ Under the Penny Pilot Program, the minimum price variation for all 13 option classes, except for the Nasdaq-100 Index Tracking Stock ("QQQs"), is \$0.01 for all quotations in option series that are quoted at less than \$3 per contract and \$0.05 for all quotations in options series that are quoted at \$3 per contract or greater. The QQQs are quoted in \$0.01 increments for all options series. A recent extension of the Penny Pilot Program is scheduled to expire on September 27, 2007.⁴ ISE now proposes to expand the Penny Pilot Program in two phases.

In both phases, the 13 options classes currently in the Penny Pilot Program would continue to be quoted as they are today. In addition, Phase I of the expansion would begin on September 28, 2007 and would continue for six months. This phase would include the 22 additional option classes noted in Exhibit 5. These 22 option classes are among the most actively traded, multiply-listed option classes based on national average daily volume, and together with the existing 13 option classes that are currently in the Penny Pilot Program, represent approximately 35% of the total industry volume.

³ See Securities Exchange Act Release No. 55161 (January 24, 2007), 72 FR 4754 (February 1, 2007) (SR-ISE-2006-62) (the "Initial Filing").

⁴ See Securities Exchange Act Release No. 56151 (July 26, 2007), 72 FR 42452 (August 2, 2007) (SR-ISE-2007-68).

Phase II of the expansion would begin on March 28, 2008 and continue for one year until March 27, 2009. It is currently anticipated that an additional 28 option classes would be added to the Penny Pilot Program on March 28, 2008, bringing the total number of option classes in the Penny Pilot Program to 63. These 28 new option classes would also be among the most actively traded, multiply-listed option classes. ISE intends to submit a proposed rule change pursuant to Section (b)(3)(A) of the Exchange Act announcing the names of these twenty-eight option classes prior to the beginning of Phase II and, pursuant to ISE Rule 710, intends to disseminate a Regulatory Information Circular.⁵

ISE believes that expanding the Penny Pilot Program as proposed by this rule filing would allow the Exchange and the Commission to further analyze, and over a longer period of time, the impact of quoting and trading option classes in penny increments and the impact of the Penny Pilot Program on liquidity, market structure and quote traffic.

As proposed in the Initial Filing, ISE represents that options trading in penny increments would not be eligible for split pricing, as permitted under ISE Rule 716. In the Initial Filing, the Exchange also referenced quote mitigation strategies that are currently in place and proposed to apply them to the Penny Pilot Program. The Exchange proposes to continue applying those quote mitigation strategies during the extension and expansion of the Penny Pilot Program, as contemplated by this rule filing. Specifically, as proposed in ISE Rule 804, ISE would continue to utilize a holdback timer that delays quotation updates for up to, but not longer than, one second. The Exchange's monitoring and delisting policies, as proposed in the Initial Filing, would also continue to apply.

⁵ Telephone conversation between Samir Patel, Assistant General Counsel, ISE, Jennifer Colihan, Special Counsel, Division of Market Regulation ("Division"), Commission, and Johnna Dumler, Special Counsel, Division, Commission on August 22, 2007.

Finally, ISE intends to submit reports to the Commission analyzing the Penny Pilot Program for the following time periods:

- May 1, 2007 – September 27, 2007
- September 28, 2007 – January 31, 2008
- February 1, 2008 – July 31, 2008
- August 1, 2008 – January 31, 2009

The Exchange anticipates its reports will analyze the impact of penny pricing on market quality and options system capacity. The Exchange will submit each report within one month following the end of the period being analyzed.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,⁶ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁷ in particular, in that the proposed rule change is 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, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will result in 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

Written comments on the proposed rule change were neither solicited nor received.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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 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 is consistent with the Act. The Commission also requests and encourages interested persons to submit comments on the following specific questions:

- Whether there are circumstances under which options classes included in the Penny Pilot should be removed from the Pilot?
- If so, what factors should be considered in making the determination to remove an option class from the Penny Pilot?
 - Should an objective standard be used? For instance, should an option class come out of the Penny Pilot if its trading volume drops below a threshold amount? If so, what should that threshold be? Or, should an option class come out of the Penny Pilot if it is no longer among the most actively-traded options? If so, what should be considered the most-actively traded options? What statistics or analysis should be used to support a determination to remove an options class?

- Should a more subjective analysis be allowed? If so, what factors should be taken into account?
- What concerns might arise by removing an option from the Penny Pilot? How could such concerns be ameliorated?
- How frequently should the analysis be undertaken (e.g., annually, bi-annually, quarterly), or should the evaluation be an automated process?
- If a determination is made that an option should be removed from the Penny Pilot, how much notice should be given to market participants that the quoting increment will change?

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-2007-74 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-2007-74. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. 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-2007-74 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

Florence E. Harmon
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).