

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50674; File No. SR-ISE-2004-09)

November 16, 2004

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendments No. 1 and No. 2 by the International Securities Exchange, Inc., Relating to the Listing and Trading of Options on the S&P 1000 Index

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 April 5, 2004, the International Securities Exchange, Inc. (“Exchange” or “ISE”) 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 ISE. The ISE submitted Amendments No. 1 and No. 2 to the proposal on July 16, 2004,³ and August 2, 2004, respectively.⁴ 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 amend its rules to list and trade options on the Standard & Poor’s 1000 Index (“S&P 1000” or “Index”). Specifically, the ISE proposes to list and trade options based on: (i) one-tenth of the value of the Index (“Reduced Value Index Options” or “Reduced Value S&P 1000 Options”); and (ii) one one-hundredth of the value of the Index (“Micro Index

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated July 15, 2004, and accompanying Form 19b-4 (“Amendment No. 1”). Amendment No. 1 replaced the filing in its entirety.

⁴ See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated July 28, 2004 (“Amendment No. 2”). Amendment No. 2 made technical changes clarifying the description of the Index and the calculation of the Index Settlement Value.

Options” or “Micro S&P 1000 Options”). The ISE also proposes to list and trade long-term Reduced Value Index Options and long-term Micro Index Options (the Reduced Value Index Options, Micro Index Options, long-term Reduced Value Index Options, and long-term Micro Index Options may be referred to, collectively, as the “Index Options”). The Index Options will be cash-settled and have European-style exercise provisions. The text of the proposed rule change appears below; additions are italicized.

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Rule 2001. Definitions

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Supplementary Material to Rule 2001

.01 The reporting authorities designated by the Exchange in respect of each index underlying an index options contract traded on the Exchange are as provided in the chart below.

<u>Underlying Index</u>	<u>Reporting Authority</u>
S&P SmallCap 600 Index	Standard & Poor’s
Morgan Stanley Technology Index	American Stock Exchange
S&P MidCap 400 Index	Standard & Poor’s
<u>S&P 1000 Index</u>	<u>Standard & Poor’s</u>

Rule 2004. Position Limits for Broad-Based Index Options

(a) Rule 412 generally shall govern position limits for broad-based index options, as modified by this Rule 2004. There may be no position limit for certain Specified (as provided in Rule 2000) broad-based index options contracts. All other broad-based index options contracts shall be subject to a contract limitation fixed by the Exchange, which shall not be larger than the limits provided in the chart below.

Broad-Based Underlying Index	Standard Limit (on the same side of the market)	Restrictions
S&P SmallCap 600 Index	100,000 contracts	No more than 60,000 near-term
S&P MidCap 400 Index	45,000 contracts	No more than 25,000 near-term
<u>Reduced Value S&P 1000 Index</u>	<u>50,000 contracts</u>	<u>No more than 30,000 near-term</u>
<u>Micro S&P 1000 Index</u>	<u>500,000 contracts</u>	<u>No more than 300,000 near-term</u>

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Rule 2009. Terms of Index Options Contracts

(a) General.

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(4) “European-Style Exercise.” The following European-style index options, some of which may be A.M.-settled as provided in paragraph (a)(5), are approved for trading on the Exchange:

- (i) S&P SmallCap 600 Index
- (ii) Morgan Stanley Technology Index
- (iii) S&P MidCap 400 Index
- (iv) Reduced Value S&P 1000 Index
- (v) Micro S&P 1000 Index

(5) A.M.-Settled Index Options. The last day of trading for A.M.-settled index options shall be the business day preceding the last day of trading in the underlying securities prior to expiration. The current index value at the expiration of an A.M.-settled index option shall be determined, for all purposes under these Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration, by reference to the reported level of such index as derived from first reported sale (opening) prices of the underlying securities on such day, except that:

(i) In the event that the primary market for an underlying security does not open for trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 2008(g), unless the current index value at expiration is fixed in accordance with the Rules and By-Laws of the Clearing Corporation; and

(ii) In the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading on that day, the price of that security, for the purposes of calculating the current index value at expiration, shall be the last reported sale price of the security.

The following A.M.-settled index options are approved for trading on the Exchange:

- (i) S&P SmallCap 600 Index
- (ii) Morgan Stanley Technology Index
- (iii) S&P MidCap 400 Index
- (iv) Reduced Value S&P 1000 Index
- (v) Micro S&P 1000 Index

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(c) Procedures for Adding and Deleting Strike Prices. The procedures for adding and deleting strike prices for index options are provided in Rule 504, as amended by the following:

(1) The interval between strike prices will be no less than \$5.00; provided, that in the case of the following classes of index options, the interval between strike prices will be no less than \$2.50:

(i) S&P SmallCap 600, if the strike price is less than \$200.00

(ii) Morgan Stanley Technology Index, if the strike price is less than \$200.00

(iii) S&P MidCap 400 Index, if the strike price is less than \$200

(iv) Reduced Value S&P 1000 Index, if the strike price is less than \$200.00

(v) Micro S&P 1000 Index, if the strike price is less than \$200.00

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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 ISE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. The ISE 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 ISE proposes to amend its rules to provide for the listing and trading on the Exchange of cash-settled, European-style Index Options. Specifically, the Exchange proposes to list and trade Reduced Value Index Options, Micro Index Options, long-term Reduced Value Index Options, and long-term Micro Index Options.⁵

Index Design and Composition

The S&P 1000 is a market capitalization-weighted index.⁶ The S&P 1000 is a combination of the S&P MidCap 400 Index and the S&P SmallCap 600 Index. The S&P MidCap 400 Index represents approximately 70% of the Index and the S&P SmallCap 600 Index represents approximately 30% of the Index.⁷ The combination is designed to address the needs of investors who want to allocate assets between large capitalization stocks, on the one hand, and small and middle capitalization stocks, on the other hand.⁸ As of February 18, 2004, 607 components in the Index were listed on the New York Stock Exchange (“NYSE”); 384 were listed on Nasdaq; and nine were listed on the American Stock Exchange (“Amex”). All Nasdaq stocks in the Index are designated as national market system securities by the National Association of Securities Dealers (“NASD”), meaning, among other things, that real-time last

⁵ Under ISE Rule 506, “Long-Term Options Contracts,” the ISE may list long-term options that expire from 12 to 39 months from the time they are listed.

⁶ The calculation of a market capitalization-weighted index involves taking the summation of the product of the price of each stock in the index and the shares outstanding for each issue. In contrast, a price-weighted index involves taking the summation of the prices of the stocks in the index.

⁷ See S&P 1000 Index description published by Standard & Poor’s (“S&P”) on S&P’s website at www.standardandpoors.com.

⁸ See Amendment No. 2, supra note 4.

sale reports are available for these stocks. The Commission previously approved the Exchange's proposals to list and trade options on the S&P SmallCap 600 Index and the S&P MidCap 400 Index.⁹

Although Standard & Poor's ("S&P") introduced the S&P 1000 in 2003, S&P calculated the Index internally for two years prior to its introduction. Because the Index is a combination of the S&P MidCap 400 Index and the S&P SmallCap 600 Index, the 1000 components of the Index consist of the 400 components included in the S&P MidCap 400 Index and the 600 components included in the S&P SmallCap 600 Index. Stated differently, when a component is added to (deleted from) either the S&P MidCap 400 Index or the S&P SmallCap 600 Index, the component is simultaneously added to (deleted from) the S&P 1000. As a result, the S&P 1000 does not have its own component inclusion or exclusion criteria. Rather, the inclusion and exclusion criteria for the S&P MidCap 400 Index and the S&P SmallCap 600 Index determine the components of the S&P 1000.

The components of the S&P MidCap 400 Index and the S&P SmallCap 600 Index are chosen on the basis of market capitalization, liquidity and industry group representation. The criteria for a component to be added to the S&P MidCap 400 Index and the S&P SmallCap 600 Index (and as a result, to the S&P 1000 Index) are as follows: the component must (i) be a U.S. company; (ii) have adequate liquidity and a reasonable price – the ratio of annual dollar value traded to market capitalization should be 0.3 or greater (very low stock prices can affect a stock's liquidity); (iii) have a market capitalization of \$1 billion to \$4 billion for the S&P MidCap 400

⁹ See Exchange Act Release Nos. 48587 (October 2, 2003), 68 FR 58154 (October 8, 2003) (order approving File No. SR-ISE-2003-18) (approving the listing and trading of options on the S&P SmallCap 600 Index); and 49696 (May 13, 2004), 69 FR 28962 (May 19, 2004) (order approving File No. SR-ISE-2004-08) (approving the listing and trading of options on the S&P MidCap 400 Index).

and \$300 million to \$1 billion for the S&P SmallCap 600 (these ranges are reviewed from time to time to assure consistency with market conditions); (iv) have financial viability, usually measured as four consecutive quarters of positive as-reported earnings (as-reported earnings are GAAP Net Income excluding discontinued operations and extraordinary items); (v) have a public float of at least 40% of the total issued and outstanding shares; (vi) maintain sector balance for each index as measured by a comparison of the Global Industry Classification Standard sectors and the relevant market capitalization ranges for each index; and (vii) be an operating company and not a closed-end fund, holding company, partnership, investment vehicle or royalty trust (real estate investment trusts are eligible for inclusion in the Index).

The following are the criteria for a component to be deleted from the Index: the component must (i) be involved in a merger, become acquired or significantly restructured such that it no longer meets the inclusion criteria; or (ii) substantially violate one or more of the addition criteria.¹⁰ Finally, the Index may not contain any component that is presently a component of the S&P 500 index.

As of March 25, 2004, the Index's components were classified in the following ten market sectors, along with their respective weightings in the Index: Energy (6.37%); Materials (4.32%); Industrials (13.96%); Consumer Discretionary (18.52%); Consumer Staples (4.45%); Health Care (12.15%); Financials (18.15%); Information Technology (16.06%); Telecommunications Services (0.51%); and Utilities (5.51%).¹¹ A complete list of the 1000 component stocks in the Index is available at the Exchange, on the Exchange's Web site, and on S&P's Web site.

¹⁰ See S&P's Web site at www.standardandpoors.com under a link entitled "Index Methodology, Criteria for Additions to and Deletions from a U.S. Index."

As set forth in Exhibit B to the proposal, as of February 18, 2004, the Index had the following characteristics: (i) the total capitalization of all of the components in the Index was \$1.474 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component was \$11.801 billion (Gilead Sciences Corp.), (b) the lowest capitalization of a component was \$72.109 million (Huffy Corp.), (c) the mean capitalization of the components was \$1.474 billion, (d) and the median capitalization of the components was \$1.019 billion; (iii) regarding component price per share, (a) the highest price per share of a component was \$910.04 (Washington Post Co.), (b) the lowest price per share of a component was \$3.40 (Milacron Inc.), (c) the mean price per share of the components was \$30.76, (d) and the median price per share of the components was \$27.61; (iv) regarding component weightings, (a) the highest weighting of a component was 0.80% (Gilead Sciences Corp.), (b) the lowest weighting of a component was 0.005% (Huffy Corp.), (c) the mean weighting of the components was 0.10%, (d) the median weighting of the components was 0.07%, and (e) the total weighting of the top five highest weighted components (Gilead Sciences Corp., M&T Bank Corp., New York Community Bancorp Inc., Coach Inc., and D.R. Horton Inc.) was 3.14%; (v) regarding component available shares (public float), (a) the most available shares of a component was 416.90 million shares (Amtel Corp.), (b) the least available shares of a component is 3.3 million shares (Haggar Corp.), (c) the mean available shares of the components was 45.78 million shares, (d) and the median available shares of the components was 32.80 million shares; (vi) regarding the six-month average daily volumes of the components, (a) the highest six-month average daily volume of a component was 12.326 million shares (Rf Micro Devices Inc.), (b) the lowest six month-average daily volume of a component was 6,910 shares (Green Mountain Power Corp.), (c) the mean six-

¹¹ These calculations are based on the index descriptions of the S&P MidCap 400 and the S&P SmallCap 600 on S&P's Web site at www.standardandpoors.com.

month average daily volume of the components was 466,190 shares, (d) the median six-month average daily volume of the components was 252,180 shares, (e) the six-month average daily volumes of the five most heavily traded components was 7.479 million shares (Rf Micro Devices Inc. (12.326 million shares), Amtel Corp. (8.69 million shares), 3Com Corp. (5.76 million shares), Sandisk Corp. (5.50 million shares), E*Trade Financial Corp. (5.11 million shares)), and (f) 93.6%, or 936 out of 1000, of the Index's components had a six-month average daily volume of at least 50,000 shares; (vii) regarding options eligibility, (a) 98.95% of the Index's components were options eligible, as measured by weighting, and (b) 98.4% of the Index's components were options eligible, as measured by number.

The S&P 1000 Index is presently a "full" market capitalization-weighted index. That is, the value of the Index is calculated by multiplying, for each component, the total number of shares outstanding by the price per share, adding these values together, and dividing the result by the Index divisor. However, on March 1, 2004, S&P announced that it would shift the S&P 500 Index, S&P MidCap 400 Index, S&P SmallCap 600 Index, and its other U.S. indexes to "float-adjusted" market capitalization weighting.¹² After the transition to float-adjusted market capitalization weighting, the value of the Index will be calculated by multiplying, for each component, the number of shares in the public float of the component by the price per share, adding these values together, and dividing the result by the Index divisor.

S&P will implement the transition from full market capitalization weighting to float-adjusted market capitalization weighting over an 18-month period. In September 2004, S&P began publishing procedures and float adjustment factors and will begin calculating provisional

¹² See S&P's press release dated March 1, 2004, ("Press Release") on S&P's website at www.standardandpoors.com. As indicated below, the ISE expects S&P's float adjustment to adjust for cross-holdings and insider holdings.

float adjusted indexes. The float adjustment factors include, among other things, information regarding the adjustments that will be made to each component to determine what each component's float will be. At that time, S&P will begin calculating provisional indexes alongside of the regular indexes so that passive indexers (institutional investors that model their portfolio construction and weighting according to S&P indexes) can control the timing of adjustments.

In March 2005, the official index series for S&P's U.S. indexes will shift to partial float adjustment, using float adjustment factors that represent half of the total adjustment, based on the information published in September 2004. In September 2005, the shift to float adjustment will be completed, the official indexes will be fully float-adjusted, and the provisional indexes will be discontinued. Float adjustment factors will be reviewed annually in September.¹³

The Exchange does not intend to trade options on any provisional index calculated during the transition period. Further, based on conversations with S&P, the Exchange does not expect that any securities or futures exchange will trade products on any provisional index during the transition period. S&P has stated that, notwithstanding the simultaneous calculation of provisional indexes, there will still be only one official set of S&P indexes.

During the transition period, S&P will adjust the divisor of the indexes to maintain continuity across the adjustments. Therefore, as a result of the divisor adjustments, the Index value will maintain continuity immediately following both adjustments (in March 2005 and September 2005). Because the Index value will maintain continuity, the value of options traded on the Index will not change as a direct result of the float adjustment. S&P does not expect any companies to be removed from the Index as a result of the adjustments. Adjusting the divisor

¹³ See Press Release, supra note 12.

ensures that the Index level is affected by the performance of individual components, rather than by share changes or component replacements.

The Exchange expects S&P's float adjustment to adjust for cross-holdings and insider holdings. The Exchange will provide a link on its Internet Web site to the page on S&P's Web site page where float adjustment information will be displayed.

According to the ISE, changes to the indexes have already been widely discussed. Major broker-dealers, including Merrill Lynch, Morgan Stanley, Lehman Brothers, JP Morgan, and others, have performed research and published material regarding the changes. Attached as Exhibit E to the proposal are copies of some of that research. S&P intends to publish more detailed procedures for the adjustments in September 2004, well before it begins making its first set of changes in March 2005. S&P also intends to announce all related information by press release and to post that information to its Web site. Due to current and anticipated coverage, the Exchange does not believe that the adjustment will surprise investors.

On March 18, 2004, the Index value was 3,370.88. The Exchange believes that this level is too high for successful options trading. Accordingly, the Exchange proposes to base trading in Index options on fractions of the Index value. In particular, the Exchange proposes to list (i) Reduced Value S&P 1000 Options that are based on one-tenth of the value of the Index, and (ii) Micro S&P 1000 Options that are based on one one-hundredth of the value of the Index.¹⁴ The Exchange believes that listing options on reduced values of the Index will attract a greater source of customer business than if options were based on the full value of the Index. The Exchange also believes that listing options on reduced values of the Index will provide an opportunity for investors to hedge, or speculate on, the market risk associated with the stocks comprising the

¹⁴ As noted above, the ISE also proposes to list long-term Reduced Value S&P 1000 Options and long-term Reduced Value Micro S&P 1000 Options.

Index. Further, by reducing the values of the Index, the ISE notes that investors will be able to utilize this trading vehicle, while extending a smaller outlay of capital. The Exchange believes that this should attract additional investors, and, in turn, create a more active and liquid trading environment.¹⁵

Index Calculation and Index Maintenance

The values of the Reduced Value S&P 1000 Index and the Micro S&P 1000 Index will each be calculated continuously, using the last sale price for each component stock in the Index, and will be disseminated every 15 seconds throughout the trading day.¹⁶ To calculate the full Index value, the sum of the market value of the stocks in the Index is divided by the base period market value (divisor), and the result is multiplied by 100. To calculate the value of the Reduced Value S&P 1000, the full Index value is divided by ten. To calculate the value of the Micro S&P 1000, the full Index value is divided by 100. To provide continuity for the Index's value, the divisor is adjusted periodically to reflect such events as changes in the number of common shares

¹⁵ The concept of listing reduced value options on an index is not a novel one. See, e.g., Securities Exchange Act Release Nos. 32893 (September 14, 1993), 58 FR 49070 (September 21, 1993) (order approving File No. SR-CBOE-93-12) (approving the listing and trading of options based on one-tenth the value of the S&P 500 Index); 43000 (June 30, 2000), 65 FR 42409 (July 10, 2000) (notice of filing and immediate effectiveness of File No. SR-CBOE-00-15) (listing and trading of options based on one-tenth of the value of the Nasdaq 100 Index); and 48681 (October 22, 2003), 68 FR 62337 (November 3, 2003) (order approving File No. SR-CBOE-2003-14) (approving the listing and trading of options based on one-tenth of the value of the NYSE Composite Index).

¹⁶ The values of the Reduced Value S&P 1000 and the Micro S&P 1000 will be calculated by S&P and disseminated to Reuters. The Exchange will receive those values from Reuters and disseminate them every 15 seconds between the hours of 9:30 a.m. and 4:15 p.m. to the Options Price Reporting Authority ("OPRA") and to its members. The Index is published daily in, among other places, The Wall Street Journal and The New York Times, and is available during trading hours from quotation vendors such as Reuters. Telephone conversation between Joseph W. Ferraro III, Assistant General Counsel, ISE, and Florence Harmon, Senior Special Counsel, Division, Commission (November 9, 2004).

outstanding for component stocks, company additions or deletions, corporate restructurings and other capitalization changes.

S&P will calculate the settlement value for purposes of settling Reduced Value S&P 1000 Options (“Reduced Value Settlement Value”) and Micro S&P 1000 Options (“Micro Settlement Value”) on the basis of opening market prices on the business day prior to the expiration date of such options (“Settlement Day”).¹⁷ The Settlement Day is normally the Friday preceding “Expiration Saturday.”¹⁸ In the event that a component security in the Index does not trade on Settlement Day, the closing price from the previous trading day is used to calculate the Settlement Value. Accordingly, trading in Reduced Value S&P 1000 Options and Micro S&P 1000 Options will normally cease on the Thursday preceding an Expiration Saturday. S&P will calculate, and the Exchange will disseminate, both the Reduced Value Settlement Value and the Micro Settlement Value.¹⁹

S&P will monitor and maintain the S&P 1000. S&P is responsible for making all necessary adjustments to the Index to reflect component deletions, share changes, stock splits, stock dividends (other than an ordinary cash dividend), and stock price adjustments due to restructuring, mergers, or spin-offs involving the underlying components. Some corporate actions, such as stock splits and stock dividends, require simple changes to the available shares outstanding and the stock prices of the underlying components. Other corporate actions, such as share issuances, change the market value of the Index and would require a change in the Index divisor to effect adjustments.

¹⁷ The aggregate exercise value of the option contract is calculated by multiplying the Index value by the Index multiplier, which is 100.

¹⁸ For any given expiration month, the Index Options will expire on the third Saturday of the month.

¹⁹ See Amendment No. 2, supra note 4.

Although the Exchange is not involved in the maintenance of the Index, the Exchange represents that it will monitor the Index on a quarterly basis and will notify the staff in the Commission's Division of Market Regulation ("Division"), pursuant to filing a proposed rule change pursuant to Rule 19b-4,²⁰ if: (i) the number of securities in the Index drops by 1/3rd or more; (ii) 10% or more of the weight of the Index is represented by component securities having a market value of less than \$75 million; (iii) less than 80% of the weight of the Index is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (iv) 10% or more of the weight of the Index is represented by component securities trading less than 20,000 shares per day; or (v) the largest component security accounts for more than 15% of the weight of the Index or the largest five components in the aggregate account for more than 50% of the weight of the Index.

The Exchange will notify the Division immediately in the event S&P determines to cease maintaining or calculating the Index or in the event the Index values are not disseminated every 15 seconds by a widely available source. In the event the Index ceases to be maintained or calculated, or disseminated every 15 seconds by a widely available source, the Exchange agrees not to list any additional series for trading and agrees to limit all transactions in such options to closing transactions only for the purpose of maintaining a fair and orderly market and protecting investors.²¹

²⁰ Telephone conversation between Joseph W. Ferraro III, Assistant General Counsel, ISE, and Florence Harmon, Senior Special Counsel, Division, Commission (November 9, 2004).

²¹ Id.

Contract Specifications

The contract specifications for both Reduced Value S&P 1000 Options and Micro S&P 1000 Options are set forth in Exhibit C to the proposal. The ISE proposes to characterize the Index as a broad-based index, as defined in ISE Rule 2001(j).²² Options on the Index are European-style and A.M. cash-settled. The Exchange's standard trading hours for index options (9:30 a.m. to 4:15 p.m., New York time), as set forth in ISE Rule 2008(a), will apply to Index Options. Exchange rules that are applicable to the trading of options on broad-based indexes will apply to the trading of Index Options.²³ Specifically, among others, Exchange rules governing margin requirements and trading halt procedures that are applicable to the trading of broad-based index options will apply to Index Options.

The Exchange proposes to establish aggregate position limits for options on the Reduced Value S&P 1000 Index at 50,000 Reduced Value S&P 1000 contracts on the same side of the market, provided no more than 30,000 of such Reduced Value S&P 1000 contracts are in the nearest expiration month series. The Exchange also proposes to establish aggregate position limits for options on the Micro S&P 1000 Index at 500,000 Micro S&P 1000 contracts on the same side of the market, provided that no more than 300,000 of the S&P 1000 Index contracts are in the nearest expiration month series. Reduced Value S&P 1000 contracts will be aggregated with Micro S&P 1000 contracts, where 10 Micro S&P 1000 contracts equal one

²² ISE Rule 2001(j) defines a "market index" or a "broad-based index" to mean an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries.

²³ See ISE Rules 2000 through 2012.

Reduced Value S&P 1000 contract. These limits are similar to the limits applicable to options on the Russell 2000 Index, a similarly capitalized index.²⁴

The Exchange proposes to apply broad-based index margin requirements for the purchase and sale of Index Options. Accordingly, purchases of put or call Index Options with nine months or less until expiration must be paid for in full. Writers of uncovered put or call Index Options must deposit/maintain 100% of the option proceeds, plus 15% of the aggregate contract value (current Index level x \$100), less any out-of-the-money amount, subject to a minimum of the option proceeds plus 10% of the aggregate contract value.

The Exchange proposes to set strike price intervals at 2 1/2 points for certain near-the-money series in near-term expiration months when the Index is at a level below 200, and 5-point strike price intervals for other Index Options series with expirations up to one year, and 25- to 50-point strike price intervals for longer-term Index Options. Accordingly, because the current Reduced Value S&P 1000 level is 337.1, the Exchange will set strike price intervals at five points for Reduced Value S&P 1000 Options. Because the current Micro S&P 1000 level is 33.71, the Exchange will set strike price intervals at 2 1/2 points for Micro S&P 1000 Options. The minimum tick size for series trading below \$3 will be 0.05, and for series trading at or above \$3 the minimum tick size will be 0.10.

The Exchange proposes to list both Reduced Value S&P 1000 Options and Micro S&P 1000 Options in the three consecutive near-term expiration months plus up to three successive expiration months in the March cycle. For example, consecutive expirations of January,

²⁴ The same limits that apply to position limits shall apply to exercise limits for these products. Telephone conversation between Joseph W. Ferraro III, Associate General Counsel, ISE, Florence Harmon, Senior Special Counsel, and A. Michael Pierson, Attorney, Division, Commission (November 16, 2004).

February, March, plus June, September, and December expirations would be listed.²⁵ In addition, long-term Index Options series having up to 39 months to expiration may be traded.²⁶ The interval between expiration months for Reduced Value S&P 1000 Index Options or Micro S&P 1000 Index Options will not be less than six months. The trading of any long-term Reduced Value S&P 1000 Options and Micro S&P 1000 Options will be subject to the same rules that govern the trading of all the Exchange's index options, including sales practice rules, margin requirements, and trading rules.

Except for the further reduced value given to the Micro S&P 1000 Options, all of the specifications and calculations for the Micro S&P 1000 Options will be the same as those used for the Reduced Value S&P 1000 Options. The Micro S&P 1000 Options will trade independently of and in addition to the Reduced Value S&P 1000 Options, and both products will be subject to the same rules that presently govern the trading of Exchange index options, including sales practice rules, margin requirements, trading rules, and position and exercise limits.

Surveillance and Capacity

The Exchange represents that it has an adequate surveillance program in place for Index Options and intends to apply those same program procedures that it applies to the Exchange's other index options. Additionally, the Exchange is a member of the Intermarket Surveillance Group ("ISG") under the Intermarket Surveillance Group Agreement, dated June 20, 1994. The

²⁵ See ISE Rule 2009(a)(3).

²⁶ See ISE Rule 2009(b)(1). The Exchange is not listing reduced value LEAPS on either of the Reduced Value S&P 1000 Indexes or Reduced Value Micro S&P 1000 Indexes pursuant to ISE Rule 2009(b)(2). Telephone conversation between Joseph W. Ferraro III, Associate General Counsel, ISE, Florence Harmon, Senior Special Counsel, and A. Michael Pierson, Attorney, Division, Commission (November 16, 2004).

members of the ISG include all of the U.S. registered stock and options markets: the Amex, the Boston Stock Exchange, the Chicago Board Options Exchange, the Chicago Stock Exchange, the National Stock Exchange, the NASD, the NYSE, the Pacific Stock Exchange and the Philadelphia Stock Exchange. The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets. In addition, the major futures exchanges are affiliated members of the ISG, which allows for the sharing of surveillance information for potential intermarket trading abuses.

The Exchange represents that it has the system capacity to adequately handle all series that would be permitted to be added by this proposal (including LEAPS). The Exchange provided to the Commission information in a confidential submission that supports its system capacity representations.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,²⁷ in general, and furthers the objectives of Section 6(b)(5),²⁸ in particular, in that it will permit trading in both Reduced Value S&P 1000 Options and Micro S&P 1000 Options pursuant to rules designed to prevent fraudulent and manipulative acts and practices and promote just and equitable principals of trade.

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

The ISE believes that the proposed rule change does not impose any burden on competition.

²⁷ 15 U.S.C. 78f(b).

²⁸ 15 U.S.C. 78f(b)(5).

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 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 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, 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 e-mail to rule-comments@sec.gov. Please include File Number SR-ISE-2004-09 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-ISE-2004-09. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the ISE. 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-2004-09 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.²⁹

Margaret H. McFarland
Deputy Secretary

²⁹ 17 CFR 200.30-3(a)(12).

