

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51410; File No. SR-ISE-2004-27)

March 22, 2005

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments No. 1 and No. 2 by the International Securities Exchange, Inc., Relating to Trading Options on Reduced Values of the NYSE U.S. 100 Index, the NYSE International 100 Index, the NYSE World Leaders Index, and the NYSE TMT Index, Including Long-Term Options

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 July 23, 2004, 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 ISE. The ISE submitted Amendments No. 1 and No. 2 to the proposal on January 5, 2005,³ and March 1, 2005, respectively.⁴ 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 is proposing to amend its rules to trade options on three broad-based indexes and one narrow-based index, whose components currently trade on the New York Stock Exchange, Inc (“NYSE”). The NYSE U.S. 100 Index, the NYSE International 100 Index and the NYSE World Leaders Index are all broad-based indexes. The NYSE TMT Index is a narrow-based index. Options on these indexes would be cash-settled and would have European-style exercise

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 set forth a list of the underlying components of the NYSE Indexes.

⁴ Amendment No. 2 replaced the original filing in its entirety, proposed a reduced number of contracts for position and exercise limits, addressed one of the events that the Exchange will monitor on an annual basis, and made other technical corrections to the filing.

provisions.

The text of the proposed rule change is available on the ISE's Web site (<http://www.iseoptions.com>), at the ISE's Office of the Secretary, and at the Commission.

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 Exchange proposes to amend its rules to provide for the listing and trading on the Exchange of cash-settled, European-style, index options on the NYSE U.S. 100 Index, the NYSE International 100 Index, and the NYSE World Leaders Index (the "Broad Based NYSE Indexes") and the NYSE TMT Index (the "Narrow Based NYSE Index") (collectively, the "NYSE Indexes").⁵ Specifically, the Exchange proposes to list options based upon (i) one-tenth of the value of the NYSE Indexes ("Mini Index Options") and (ii) one one-hundredth of the value of the NYSE Indexes ("Micro Index Options"). In Amendment No. 2, which replaced the original filing in its entirety, the ISE proposed a reduced number of contracts for position and exercise limits, addressed one of the events that the Exchange will monitor on an annual basis, and made other technical corrections to the filing.

⁵ A description of each of the NYSE Indexes can be found on the NYSE's Web site at <http://www.nyseindexes.com>.

Index Design and Composition

The NYSE Indexes are designed to be a comprehensive representation of the investable United States equity market. Each NYSE Index is a float-adjusted capitalization-weighted index,⁶ whose components are all traded on the NYSE.

NYSE U.S. 100 Index

The NYSE U.S. 100 Index tracks the top 100 U.S. stocks trading on the NYSE. The companies represented have a market capitalization of \$5.95 trillion, which covers 47% of the entire market capitalization of U.S. companies and over 62% of U.S. companies listed on the NYSE. Additionally, these companies are major market participants, most of which are well-known household names. This fact, along with the NYSE's significant U.S. market penetration, ensures that this index will closely track the entire U.S. market. This index is designed to assist investors looking to track the U.S. market across 10 industry sectors, as defined by Dow Jones & Company ("Dow Jones").

The NYSE U.S. 100 Index is calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all U.S. stocks listed on the NYSE. The entire index universe is ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, i.e., average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies are then selected from the remaining universe, and the index is weighted by float-adjusted market capitalization.

⁶ The calculation of a float-adjusted, market-weighted index involves taking the summation of the product of the price of each stock in the index and the number of shares available to the public for trading, rather than the total shares outstanding for each issue. In contrast, a price-weighted index involves taking the summation of the prices of the stocks in the index.

The index is reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universe is ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. In addition to the scheduled quarterly review, the index is reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

The NYSE U.S. 100 Index components are classified in ten market sectors. As of March 18, 2004, these sectors and their respective weightings were: Basic Materials (1.9%); Consumer, Cyclical (13.4%); Consumer, Non-Cyclical (11.4%); Energy (7.5%); Financial (23.3%); Healthcare (18.7%); Industrial (10.7%); Technology (5.9%); Telecommunication (6.7%); and Utilities (0.5%).

As set forth in Exhibit 3 to the proposal, as of March 18, 2004, following are the characteristics of the NYSE U.S. 100 Index: (i) the total capitalization of all of the components in the Index is \$6.166 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component is \$310.02 billion (General Electric), (b) the lowest capitalization of a component is \$17.13 billion (Kohl's Corp.), (c) the mean capitalization of the components is \$61.665 billion, and (d) the median capitalization of the components is \$40.673 billion; (iii) regarding component price per share, (a) the highest price per share of a component is \$106.82 (Genentech), (b) the lowest price per share of a component is \$11.16 (Liberty Media Group), (c) the mean price per share of the components is \$48.53, and (d) the median price per share of the components is \$44.40; (iv) regarding component weightings, (a) the highest weighting of a component is 5.03% (General Electric), (b) the lowest weighting of a component is 0.28%

(Kohl's Corp.), (c) the mean weighting of the components is 1.0%, (d) the median weighting of the components is 0.66%, and (e) the total weighting of the top five highest weighted components is 22.2% (General Electric, ExxonMobil, Pfizer, Citigroup, Wal-Mart Stores); (v) regarding component available shares, (a) the most available shares of a component is 9.98 billion (General Electric), (b) the least available shares of a component is 206 million (Genentech), (c) the mean available shares of the components is 1.396 billion, and (d) the median available shares of the components is 918.3 million; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 22.428 million (AT&T Wireless), (b) the lowest six month average daily volume of a component is 906,810 (SunTrust Banks), (c) the mean six month average daily volume of the components is 5.376 million, (d) the median six month average daily volume of the components is 4.082 million, (e) the average of six month average daily volumes of the five most heavily traded components is 18.953 million (AT&T Wireless, General Electric, Pfizer, Time Warner, Motorola), and (f) 100% of the components had a six month average daily volume of at least 50,000; and (vii) regarding option eligibility, (a) 100% of the components are options eligible, as measured by weighting and (b) 100% of the components are options eligible, as measured by number.

NYSE International 100 Index

The NYSE International 100 Index is designed to assist investors seeking to track international markets. This index tracks the 100 largest non-U.S. stocks trading on the NYSE. It covers 27.1% of the international stock market and has a total market capitalization of \$3.8

trillion. Currently, the components of the NYSE International 100 Index represent 18 countries.⁷ All of the components of this index are priced on the NYSE during U.S. trading hours. ISE believes its limited number of components and intraday pricing makes the NYSE International 100 Index suitable for tracking the non-U.S. market and for use as the basis for investable products.

The NYSE International 100 Index is also calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all non-U.S. stocks listed on the NYSE. The entire index universe is ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, *i.e.*, average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies are then selected from the remaining universe, and the index is weighted by float-adjusted market capitalization.

The index is reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universe is ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The

⁷ According to the ISE, 98 of the 100 underlying components in the NYSE International 100 Index meet ISE's listing criteria for equity options as set forth in ISE Rule 502. This represents 97.93% of the index by market capitalization weight and 98% by number. Two American Depositary Receipts ("ADRs") underlying the NYSE International 100 Index, Allianz AG ("AZ") and Telefonica Moviles SA ("TEM"), do not meet the requirements of ISE Rule 502, because the NYSE does not have in place an effective surveillance sharing agreement with the primary exchange in the home country where AZ and TEM are traded. However, the US market for the underlying ADRs is at least 50% or more of the worldwide trading volume. The Commission believes that it is appropriate to permit the listing of options on an ADR without the existence of a comprehensive surveillance agreement with the foreign market where the underlying component trades, as long as the US market for the underlying ADR is at least 50% or more of the worldwide trading volume. Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and A. Michael Pierson, Attorney, Division, Commission (March 21, 2005).

remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. In addition to the scheduled quarterly review, the index is reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

The NYSE International 100 Index components are classified in ten market sectors. As of March 18, 2004, these sectors and their respective weightings were: Basic Materials (3.1%); Consumer, Cyclical (11.1%); Consumer, Non-Cyclical (5.2%); Energy (17.7%); Financial (27.7%); Healthcare (12.0%); Industrial (1.1%); Technology (8.3%); Telecommunication (10.6%); and Utilities (3.2%).

As set forth in Exhibit 3 to the proposal, as of March 18, 2004, following are the characteristics of the NYSE International 100 Index: (i) the total capitalization of all of the components in the Index is \$4.308 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component is \$182.444 billion (BP plc), (b) the lowest capitalization of a component is \$4.99 billion (Rinker Group), (c) the mean capitalization of the components is \$43.086 million, and (d) the median capitalization of the components is \$30.612 million; (iii) regarding component price per share, (a) the highest price per share of a component is \$117.73 (National Australia Bank), (b) the lowest price per share of a component is \$5.33 (United Microelectronics), (c) the mean price per share of the components is \$37.73, and (d) the median price per share of the components is \$33.91; (iv) regarding component weightings, (a) the highest weighting of a component is 4.23% (BP plc), (b) the lowest weighting of a component is 0.05% (Rinker Group), (c) the mean weighting of the components is 1.0%, (d) the median weighting of the components is 0.71%, and (e) the total weighting of the top five highest weighted components is 16.96% (BP plc, Vodafone, HSBC Holdings, Toyota, and

GlaxoSmithKline); (v) regarding component available shares, (a) the most available shares of a component is 6.82 billion (Vodafone), (b) the least available shares of a component is 93.55 million (Rinker Group), (c) the mean available shares of the components is 1.581 billion, and (d) the median available shares of the components is 1.079 million; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 39.803 million (Nortel), (b) the lowest six month average daily volume of a component is 9,150 (Westpac Banking), (c) the mean six month average daily volume of the components is 1.054 million, (d) the median six month average daily volume of the components is 197,450, (e) the average of six month average daily volumes of the five most heavily traded components is 13.023 million (Nortel, Nokia, Taiwan Semiconductor, United Microelectronics, BP plc), and (f) 79% of the components had a six month average daily volume of at least 50,000; and (vii) regarding option eligibility, (a) 88.15% of the components are options eligible, as measured by weighting and (b) 79% of the components are options eligible, as measured by number.

NYSE World Leaders Index

The NYSE World Leaders is designed to serve as a benchmark to track, as a single asset class, the performance of 200 world leaders across 10 industry sectors and all regions of the world. This index is constructed by combining the NYSE U.S. 100 Index and NYSE International 100 Indexes. The components of the NYSE World Leaders Index have a total market capitalization of \$9.7 trillion and cover 36.7% of the market capitalization of the world markets. It is well diversified across 10 industry sectors, as defined by Dow Jones, and currently represents 19 countries, including the United States. All of the components of this index are priced on the NYSE during U.S. trading hours. The ISE believes the limited number of

components and intraday pricing makes the NYSE World Leaders Index suitable for tracking the global market and for use as the basis for investable products.

The NYSE World Leaders Index is also calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all stocks listed on the NYSE. The index universes for the NYSE U.S. 100 and NYSE International 100 are each ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, i.e., average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies are then selected from the remaining stocks in each universe, and the index is weighted by float-adjusted market capitalization.

The NYSE U.S. 100 and the NYSE International 100 Indexes are reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universes are ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. In addition to the scheduled quarterly review, the index is reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

The NYSE World Leaders Index components are classified in ten market sectors. As of March 18, 2004, these sectors and their respective weightings were: Basic Materials (2.3%); Consumer, Cyclical (12.6%); Consumer, Non-Cyclical (9.2%); Energy (11.2%); Financial (24.1%); Healthcare (16.3%); Industrial (7.2%); Technology (6.8%); Telecommunication (8.1%); and Utilities (1.5%).

As set forth in Exhibit 3 to the proposal, as of March 18, 2004, following are the characteristics of the NYSE World Leaders Index: (i) the total capitalization of all of the components in the Index is \$10.533 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component is \$310.02 billion (General Electric), (b) the lowest capitalization of a component is \$4.99 billion (Rinker Group), (c) the mean capitalization of the components is \$52.668 billion, and (d) the median capitalization of the components is \$37.291 billion; (iii) regarding component price per share, (a) the highest price per share of a component is \$117.73 (National Australia Bank), (b) the lowest price per share of a component is \$5.33 (United Microelectronics), (c) the mean price per share of the components is \$43.39, and (d) the median price per share of the components is \$40.59; (iv) regarding component weightings, (a) the highest weighting of a component is 2.94% (General Electric), (b) the lowest weighting of a component is 0.05% (Rinker Group), (c) the mean weighting of the components is 1.08%, (d) the median weighting of the components is 0.36%, and (e) the total weighting of the top five highest weighted components is 12.99% (General Electric, ExxonMobil, Pfizer, Citigroup, Wal-Mart Stores); (v) regarding component available shares, (a) the most available shares of a component is 9.98 billion (General Electric), (b) the least available shares of a component is 93.55 million (Rinker Group), (c) the mean available shares of the components is 1.326 billion, and (d) the median available shares of the components is 865.3 million; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 39.803 million (Nortel), (b) the lowest six month average daily volume of a component is 9,150 (Westpac Banking), (c) the mean six month average daily volume of the components is 3.218 million, (d) the median six month average daily volume of the components is 1.73 million, (e) the average of six month average daily volumes of the five most heavily

traded components is 24.16 million (Nortel, AT&T Wireless, General Electric, Pfizer, Time Warner), and (f) 89.5% of the components had a six month average daily volume of at least 50,000; and (vii) regarding option eligibility, (a) 95.1% of the components are options eligible, as measured by weighting, and (b) 89.5% of the components are options eligible, as measured by number.

NYSE TMT Index

The NYSE TMT Index is a narrow-based index. For narrow-based indexes that meet the standards of an exchange's rules, an SRO need only complete Form 19b-4(e) at least five business days after commencement of trading the new product. Since the listing of this product does not meet all of the requirements of ISE Rule 2002(b), Form 19b-4(e) is not available for the listing of this product, giving rise to the need for this filing.

The NYSE TMT Index is designed to track the top 100 technology, media and telecommunications stocks listed on the NYSE. The companies represented have a market capitalization of \$2.3 trillion, which covers 45.7% of the entire market capitalization of technology, media and telecommunication companies globally and is approximately the same size as the nearly 4,000 companies in the Nasdaq Composite Index. All of the components of this index are priced on the NYSE during U.S. trading hours.

The NYSE TMT Index is also calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all technology, media and telecommunication stocks listed on the NYSE. The entire index universe is ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, i.e., average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies

are then selected from the remaining universe, and the index is weighted by float-adjusted market capitalization.

The index is reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universe is ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. At the quarterly rebalancing, market sector weights for technology, media and telecommunications are capped at no more than 40% and the sub-group weights are capped at no more than 20%. This ensures that one sector or sub-group does not dominate the index. In addition to the scheduled quarterly review, the index is also reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

The NYSE TMT Index components are classified in 14 industry sub-groups within the technology, media and telecommunication sectors. As of March 18, 2004, the sub-groups and their respective weightings were: Advertising (1.9%); Broadcasting (18.9%); Communications Technology (11.8%); Computers (13.0%); Diversified Technology Services (2.4%); Entertainment (0.3%); Fixed-line Communications (20.9%); Internet Services (0.0%); Office Equipment (1.2%); Publishing (6.1%); Semiconductors (10.8%); Technology, Software (2.8%); Wireless Communications (9.9%); and Other: Non-Technology, Media and Telecommunication (0.0%).

As set forth in Exhibit 3 to the proposal, as of March 18, 2004, following are the characteristics of the NYSE TMT Index: (i) the total capitalization of all of the components in the Index is \$2.701 trillion; (ii) regarding component capitalization, (a) the highest capitalization

of a component is \$165.12 billion (Vodafone Group), (b) the lowest capitalization of a component is \$2.89 billion (Westwood One, Inc.), (c) the mean capitalization of the components is \$27.01 billion, and (d) the median capitalization of the components is \$15.38 billion; (iii) regarding component price per share, (a) the highest price per share of a component is \$115.13 (Mobile Telesystems), (b) the lowest price per share of a component is \$3.93 (Lucent Technologies Inc.), (c) the mean price per share of the components is \$30.05, and (d) the median price per share of the components is \$25.98; (iv) regarding component weightings, (a) the highest weighting of a component is 6.11% (Vodafone Group), (b) the lowest weighting of a component is 0.11% (Westwood One Inc.), (c) the mean weighting of the components is 1.0%, (d) the median weighting of the components is 0.57%, and (e) the total weighting of the top five highest weighted components is 23.62% (Vodafone Group, International Business Machines Corp., NTT Docomo Inc., Verizon Communications, and Nokia Corp.); (v) regarding component available shares, (a) the most available shares of a component is 6.82 billion (Vodafone Group), (b) the least available shares of a component is 0.08 billion (Knight Ridder Inc.), (c) the mean available shares of the components is 1.37 billion, and (d) the median available shares of the components is 0.76 billion; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 72.058 million (Lucent Technologies Inc.), (b) the lowest six month average daily volume of a component is 1.53 million (Telekom Austria Ag), (c) the mean six month average daily volume of the components is 4.138 million, (d) the median six month average daily volume of the components is 1.302 million, (e) the average of six month average daily volumes of the five most heavily traded components is 33,526 million (Lucent Technologies Inc., Nortel Networks Corp., AT&T Wireless Services Inc., Time Warner Inc., and Motorola Inc.), and (f) 86% of the components

had a six month average daily volume of at least 50,000; and (vii) regarding option eligibility, (a) 100% of the components are options eligible, as measured by weighting and (b) 100% of the components are options eligible, as measured by number.

Index Calculation and Index Maintenance

On March 18, 2004, the index value for the NYSE U.S. 100, the NYSE International 100, the NYSE World Leaders and the NYSE TMT was 5763.80, 4505.70, 5273.40, and 5060.90, respectively. The Exchange believes that these levels are too high for successful options trading. Accordingly, the Exchange proposes to base trading in these options on fractions of each of the NYSE Indexes' value. In particular, the Exchange proposes to list (i) Mini Index Options that are based on one-tenth of the value of each of the NYSE Indexes and (ii) Micro Index Options that are based on one one-hundredth of the value of each of the NYSE Indexes. The Exchange believes that listing options on reduced values will attract a greater source of customer business than if options were based on the full value of the Index. The Exchange further believes that listing options on reduced values will provide an opportunity for investors to hedge, or speculate on, the market risk associated with the stocks comprising the NYSE Indexes. Additionally, by reducing the values of the NYSE Indexes, 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.⁸

⁸ 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).

The Mini Index Options level and the Micro Index Options level shall each be calculated continuously, using the last sale price for each component stock in each of the NYSE Indexes, and shall be disseminated every 15 seconds throughout the trading day.⁹ To calculate the full value of the NYSE Indexes, the sum of the market value of the stocks in each of the NYSE Indexes is divided by the base period market value (divisor), and the result is multiplied by 100. To calculate the value of the Mini Index Options level, the full value of each of the NYSE Indexes is divided by ten. To calculate the value of the Micro Index Options level, the full value of each of the NYSE Indexes is divided by one hundred. In order to provide continuity for each of the NYSE Indexes' value, the divisor is adjusted periodically to reflect such events as changes in the number of common shares outstanding for component stocks, company additions or deletions, corporate restructurings and other capitalization changes.

The settlement value for purposes of settling Mini Index Options (“Mini Settlement Value”) and Micro Index Options (“Micro Settlement Value”) shall each be calculated on the basis of opening market prices on the business day prior to the expiration date of such options (“Settlement Day”).¹⁰ The Settlement Day is normally the Friday preceding “Expiration Saturday.”¹¹ 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.

⁹ The Mini Index Options level and the Micro Index Options level shall each be calculated by Dow Jones on behalf of the NYSE and disseminated to the Consolidated Quote System (“CQS”). The Exchange shall receive those values from CQS and disseminate them to its members. Each of the NYSE Indexes is published daily in real-time on the NYSE’s public website and through, among other places, major quotation vendors such as Reuters and Thomson’s ILX.

¹⁰ The aggregate exercise value of the option contract is calculated by multiplying the Index value by the Index multiplier, which is 100.

¹¹ For any given expiration month, options on the NYSE Indexes will expire on the third Saturday of the month.

Accordingly, trading in Mini Index Options and Micro Index Options will normally cease on the Thursday preceding an Expiration Saturday. Dow Jones shall calculate, and the Exchange shall disseminate, both the Mini Settlement Value and the Micro Settlement Value in the same manner as the Dow Jones shall calculate, and the Exchange shall disseminate, the Mini Index Options level and the Micro Index Options level.

Dow Jones will monitor and maintain each of the NYSE Indexes. Dow Jones is responsible for making all necessary adjustments to each of the NYSE Indexes 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 each of the NYSE Indexes and would require the use of an index divisor to effect adjustments.

Although the Exchange is not involved in the maintenance of the NYSE Indexes, the Exchange represents that it will monitor the NYSE Indexes on a quarterly basis,¹² at which point the Exchange will notify the Market Regulation Division of the Commission if: (i) the number of securities in each of the NYSE Indexes drops by 1/3rd or more; (ii) 10% or more of the weight of each of the NYSE Indexes is represented by component securities having a market value of less than \$75 million; (iii) less than 80% of the weight of each of the NYSE Indexes is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (iv) 10% or more of the weight of each of the NYSE Indexes is represented by component securities trading less than 20,000 shares per day; or (v) the largest component security accounts

¹² Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and A. Michael Pierson, Attorney, Division, Commission (March 21, 2005).

for more than 15% of the weight of each of the NYSE Indexes or the largest five components in the aggregate account for more than 40% of the weight of each of the NYSE Indexes.

The Exchange will notify the Market Regulation Division of the Commission immediately in the event Dow Jones determines to cease maintaining or calculating the NYSE Indexes. In the event any of the NYSE Indexes ceases to be maintained or calculated, the Exchange may determine not to list any additional series for trading or limit all transactions in such options to closing transactions only for the purpose of maintaining a fair and orderly market and protecting investors.

Contract Specifications

The contract specifications for both Mini Index Options and Micro Index Options for each of the NYSE Indexes are set forth in Exhibit 3 to the proposal. The NYSE U.S. 100, the NYSE International 100 and the NYSE World Leaders Indexes are each broad-based, as defined in Exchange Rule 2001(j).¹³ The NYSE TMT Index is a narrow-based index, as defined in Exchange Rule 2001(i).¹⁴ Options on the NYSE Indexes 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 Rule 2008(a), will apply to the NYSE Indexes. Exchange rules that are applicable to the trading of options on both broad-based indexes and narrow-based indexes will apply to the trading of Mini Index Options and Micro Index Options.¹⁵ Specifically, the trading of Mini Index Options and Micro Index Options on the NYSE Indexes will be subject to,

¹³ 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.

¹⁴ ISE Rule 2001(i) defines an "industry index" or a "narrow-based index" to mean an index designed to be representative of a particular industry or a group of related industries.

¹⁵ See ISE Rules 2000 through 2012.

among others, Exchange rules governing sales practice rules, margin requirements, trading rules, and position and exercise limits.

For each of the broad-based NYSE Indexes, the Exchange proposes to establish aggregate position and exercise limits for Mini Index Options at 50,000 contracts on the same side of the market, provided no more than 30,000 of such contracts are in the nearest expiration month series. The Mini Index Options contracts shall be aggregated with Micro Index Options contracts, where ten (10) Micro Index Options contracts equal one (1) Mini Index Options contract. For the narrow-based index, the aggregate position and exercise limits shall be as set forth under Rule 2005(a)(3).

The Exchange proposes to apply index margin requirements for the purchase and sale of options on the NYSE Indexes. Accordingly, purchases of put or call options with 9 months or less until expiration must be paid for in full. Writers of uncovered put or call 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 for call options and a minimum of the option proceeds plus 10% of the aggregate exercise price amount for put options.

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 each of the NYSE Indexes is at a level below 200, and 5 point strike price intervals for other options series with expirations up to one year, and 25 to 50 point strike price intervals for longer-term options. Accordingly, since the current Mini Index Options level for each of the NYSE Indexes is 576.38, 450.57, 527.34 and 506.09, the Exchange shall set strike price intervals at 5 points for the Mini Index Options. Since the current Micro Index Options level for each of the NYSE Indexes is 57.64, 45.06, 52.73 and 50.61, the

Exchange shall set strike price intervals at 2 1/2 points for the Micro Index Options. The minimum tick size for series trading below \$3 shall be 0.05, and for series trading at or above \$3 shall be 0.10.

The Exchange proposes to list Mini Index Options and Micro Index 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, February, March, plus June, September, and December expirations would be listed.¹⁶ In addition, long-term option series (“LEAPS”) having up to 36 months to expiration may be traded.¹⁷ The interval between expiration months on the Mini Index Options or Micro Index Options shall not be less than six months. The trading of any LEAPS on Micro Index Options and Mini Index Options shall be subject to the same rules that govern the trading of all the Exchange’s index options, including sales practice rules, margin requirements, trading rules, and position and exercise limits.

Except for the further reduced value given to the Micro Index Options, all of the specifications and calculations for the Micro Index Options shall be the same as those used for the Mini Index Options. The Micro Index Options will trade independently of and in addition to the Mini Index Options, and both products shall 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.

¹⁶ See ISE Rule 2009(a)(3).

¹⁷ See ISE Rule 2009(b)(1). The Exchange is not listing reduced value LEAPS on either of the Reduced Value NYSE Indexes or Reduced Value Micro NYSE Indexes pursuant to ISE Rule 2009(b)(2). Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and A. Michael Pierson, Attorney, Division, Commission (March 8, 2005).

Surveillance and Capacity

The Exchange represents that it has an adequate surveillance program in place for options traded on the NYSE Indexes, 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 members of the ISG include all of the U.S. registered stock and options markets: the American Stock Exchange, the Boston Stock Exchange, the Chicago Board Options Exchange, the Chicago Stock Exchange, the National Stock Exchange, the National Association of Securities Dealers, the New York Stock Exchange, 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,¹⁸ in general, and furthers the objectives of Section 6(b)(5),¹⁹ in particular, in that it will permit trading in both Mini Index Options and Micro Index Options pursuant to rules designed to

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

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.

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 self-regulatory organization 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. 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 No. SR-ISE-2004-27 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-2004-27. 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 Commissions Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2004-27 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).