

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52729; File No. SR-ISE-2005-48)

November 3, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendments No. 1 and No. 2 Thereto Relating to Market Maker Quote Interaction

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 October 3, 2005, the International Securities Exchange, Inc. (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On October 21, 2005, the ISE submitted Amendment No. 1 to the proposed rule change.³ On November 3, 2005, the ISE submitted Amendment No. 2 to the proposed rule change.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 proposes to amend its rules regarding a delay of up to one second before two market maker quotations interact. The text of the proposed rule change is as follows. Proposed new language is underlined; proposed deletions are in [brackets].

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Form 19b-4 dated October 21, 2005, which replaced the original filing in its entirety (“Amendment No. 1”).

⁴ See partial amendment dated November 3, 2005, which corrected a minor omission in the current rule text and a typographical error in the filing (“Amendment No. 2”).

Rule 804. Market Maker Quotations

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(d) Firm Quotes. (1) Market maker bids and offers are firm for orders and Exchange market maker quotations both under this Rule and Rule 602 of Regulation NMS[11Ac1-1] under the Exchange Act (“Rule 602 of Reg NMS[11Ac1-1]”) for the number of contracts specified according to the requirements of paragraph (b) above. Market maker bids and offers are not firm under this Rule and Rule 602 of Reg NMS[11Ac1-1] if:

- (i) a system malfunction or other circumstance impairs the Exchange’s ability to disseminate or update market quotes in a timely and accurate manner;
- (ii) the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing, and making available to quotation vendors the data for the option in a manner that accurately reflects the current state of the market on the Exchange, and as a result, the market in the option is declared to be “fast” pursuant to Rule 704;
- (iii) during trading rotations; or
- (iv) any of the circumstances provided in paragraph (c)(3) of Rule 602 of Reg NMS[11Ac1-1] exist.

(2) Notwithstanding Paragraph (1) above, if a market maker's bid (offer) can trade with the offer (bid) of another market maker, the Exchange shall have the authority to implement a delay so that no execution shall occur between such quotations for a period of no more than one second. During such [this] period, the System will update quotations that may be received; provided however, that during such [this] period all quotations shall otherwise remain firm and

the System shall [will] automatically execute all incoming orders against such quotations.

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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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

In June 2004, the Commission approved a proposed rule change by the Exchange adopting a delay of up to one second before two market maker quotations at the same price would trade.⁵ As represented in the June 2004 Filing, the ISE treats orders and

⁵ See Securities Exchange Act Release No. 49931 (June 28, 2004), 69 FR 40696 (July 6, 2004) ("June 2004 Filing").

quotations differently, with ISE Rule 804(a) stating that only market makers may enter quotations on the ISE. Market makers use quotations to input and update prices on multiple series of options at the same time. Quotations generally are based on pricing models that rely on various factors, including the price and volatility of the underlying security. The ISE states that as these variables change, a market maker's pricing model automatically updates quotations for some or all of an option's series. In contrast, an order is an interest to buy a stated number of contracts of one specific options series. The ISE states that all ISE members, including ISE market makers, can enter orders.⁶

The ISE states that the purpose of the one-second delay adopted by the June 2004 Filing was to allow a market maker to update its quotation to reflect price changes in an underlying stock before another market maker's quotation would "hit" its quote. During this brief period, market maker quotations remain firm for all orders the ISE receives. This includes orders from customers, broker-dealers and even other market makers. The only exclusion is for executions against other market maker quotes.

However, as the ISE trading system and its market maker members' quoting systems continue to advance technologically, the ISE believes that, at some point, providing this one-second delay may no longer be necessary. Thus, in order to have the flexibility to remove this delay at that point, the ISE proposes to amend this rule to specify that this is a functionality that the ISE can, but is not required, to use. Additionally, if the Exchange determines to remove the

⁶ ISE Rule 717 imposes various limitations on orders that Electronic Access Members may enter on the ISE, while ISE Rule 805 governs market maker orders.

one-second delay entirely, this proposed rule change would give ISE the ability to reinstate the one-second delay, if needed, due to, for example, such removal resulting in a disruption to the market or other unintended consequences. In making any determination to remove the delay, the Exchange would take into consideration input from its market maker members, particularly through the Exchange's Market Maker Advisory Committee.

The Exchange notes that any change made to this functionality would be implemented in a uniform, market-wide basis (as opposed to, for example, a class-by-class basis). The Exchange would inform its members of any changes made to this functionality by distributing a Regulatory Information Circular prior to the implementation of any change.

2. Statutory Basis

The Exchange believes the proposal is consistent with Section 6(b) of the Act⁷, in general, and furthers the objectives of Section 6(b)(5) of the Act,⁸ in particular, in that it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest in that it would promote efficient interaction of market maker quotations.

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

The Exchange believes the proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

⁷ 15 U.S.C. 78f(b).

⁸ 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

No written comments were solicited or received by the Exchange on this proposal.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve the proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, 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 an e-mail to rule-comments@sec.gov. Please include File Number SR-ISE-2005-48 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-ISE-2005-48. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2005-48 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Jonathan G. Katz
Secretary

⁹ 17 CFR 200.30-3(a)(12).