

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52856; File No. SR-ISE-2005-46)

November 30, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing of Proposed Rule Change Relating to the Operation of Primary Market Maker Memberships

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 September 27, 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 ISE. 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 Exchange proposes to amend its rules to raise from two to three the number of Primary Market Maker (“PMM”) memberships an ISE member may operate.

The text of the proposed rule change is below. Proposed new language is underlined; proposed deletions are in [brackets].

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Rule 303. Approval to Operate Multiple Memberships

(a) An applicant to become a Member or an approved Member may seek approval to exercise trading privileges associated with more than one Membership in the form and manner prescribed by the Exchange.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(b) An applicant or approved Member will be denied approval with respect to a particular Membership if (together with any of its affiliates) approval would result in the applicant or approved Member being approved to exercise the trading privileges associated with more than one (1) Primary Market Maker Membership or more than ten (10) Competitive Market Maker Memberships. This requirement may be waived by the Board for good cause shown, but in no event shall the Board waive this requirement if such waiver would result in the applicant or approved Member (together with any of its affiliates) being approved to exercise trading privileges associated with more than 30% [20%] of the outstanding Primary Market Maker Memberships or more than 20% of the outstanding Competitive Market Maker Memberships.

Supplementary Material to Rule 303

.01 When making its determination whether good cause has been shown to waive the limitations contained in Rule 303(b), the Board will consider whether an operational, business or regulatory need to exceed the limits has been demonstrated. In those cases where such a need is demonstrated, the Board also will consider any operational, business or regulatory concerns that might be raised if such a waiver were granted. The Board only will waive such limitations when, in its judgment, such action is in the best interest of the Exchange.

.02 In approving any Primary Market Maker to exercise the trading privileges associated with more than 20% of the outstanding Primary Market Maker Memberships, the Board will not approve any arrangement in which such Primary Market Maker would gain ownership or voting rights in excess of those permitted under the Exchange's Certificate of Incorporation or Constitution.

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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, 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. 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

The Exchange proposes to amend its rules to increase the number of PMM memberships that an ISE member may operate from two to three.³ A PMM membership manifests itself as a share of ISE Class B Common Stock, Series B-1, of which there are 10 shares authorized and outstanding. ISE's Certificate of Incorporation ("Certificate") currently prohibits a member from owning (or voting the shares representing) more than 20 percent of the class of any ISE stock, thus limiting any one person from owning more than two PMM memberships.⁴ Similarly, ISE's rules prohibit a member from operating more than 20 percent of a class of market maker memberships.⁵ The result is that no one person can own, vote or operate more than two PMMs.

³ A PMM serves a function similar to that of a specialist on other exchanges. Among other things, a PMM must provide continuous quotations in all assigned options classes and must address customer orders when another exchange is displaying a better price. See ISE Rule 803(c).

⁴ See Sections III(a)(ii) and (b) of ISE's Certificate.

⁵ See ISE Rule 303(b).

Due to the continued concentration and specialization in the options market making community, ISE is proposing to raise the limit on the number of PMMs one firm can operate from two to three. ISE believes this change is part of the natural evolution of the markets. Specifically, as competition inside and between exchanges increases, there continues to be consolidation and contraction of market makers. ISE believes that this evolution will result in a smaller number of strong, competitive market makers that will provide the Exchange with excellent market making capabilities. ISE believes that this is similar to the concentration of specialist units on the major equity exchanges, such as the New York Stock Exchange (“NYSE”), where there currently are only seven specialist units, down from over three dozen.⁶

The Exchange is concerned that, as the number of strong market makers decreases, there may not be a sufficient number of members qualified to be PMMs if it retains the current two-PMM limit. ISE currently has seven PMMs operating the 10 PMM memberships, with three PMMs operating two such memberships and four PMMs operating one. While there is a constant entry and exit into options market making, ISE believes that if there is further contraction in the market making community, the Exchange may find itself with an insufficient number of PMMs to cover all ten memberships.

In addition, the options markets are highly competitive, and each exchange actively seeks to attract order flow by disseminating tight and liquid markets and by providing a high level of customer satisfaction. Ensuring that the Exchange has high quality PMMs is critical in this competitive battle. By limiting a member to operating two PMM memberships, the Exchange

⁶ As of December 31, 1992 there were 40 specialist firms on the NYSE; as recently as December 31, 1997 there were 37 specialist firms. See Shawn A. Corwin, Specialist Portfolios, Specialist Performances, and New Listing Allocations on the NYSE 7-8 (University of Georgia, Working Paper, 1999).

believes it could be forced to approve the operation of a PMM by a weaker member while a stronger PMM operating two such memberships also would be willing to operate such membership.

The Exchange recognizes that increasing the number of PMM memberships a member can operate could raise issues regarding concentration of market making expertise. In this regard, the proposal is only for an enabling rule. The ISE Board would need to approve any member application to operate three PMMs and would need to find “good cause” to do so. Thus, the Board will need to weigh each potential application on its own merits, balancing the potential benefits of allowing a member to operate three PMM memberships against any potential concentration concerns.

This proposed rule change would not amend the current prohibitions in the Certificate against a member owning or voting more than two such memberships. Thus, the only way a member could operate a third PMM membership would be to lease such membership, with the lease providing that the lessor retains all voting rights.⁷ The proposed Supplementary Material .02 to Rule 303 makes this point clear. However, the Exchange believes it may be appropriate to permit a member to own and vote three PMM memberships. Thus, upon approval of this proposed rule change, the ISE Board would consider an additional proposed change to the Certificate regarding ownership and voting limitations. If the ISE Board approves such a change

⁷ ISE has confirmed that (i) it will not approve any leasing arrangements under this proposed rule change unless the lessor/owner retains all voting rights and (ii) the voting limitations contained in the Certificate supersede any of the lessor/owner’s rights to transfer voting rights. Telephone call between Nancy Sanow, Assistant Director, Commission; Leah Mesfin, Special Counsel, Commission; Rahman Harrison, Attorney, Commission; and Michael Simon, General Counsel and Secretary, ISE on November 18, 2005.

the Exchange would need to seek stockholder approval of that change before submitting it to the Commission for its consideration.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act⁸ in general, and furthers the objectives of Section 6(b)(5) of the Act⁹ in particular, in that it is designed to promote just and equitable principles of trade and to remove impediments to and perfect the mechanisms of a free and open market and a national market system. In particular, the proposed rule change would provide the Exchange with greater flexibility in ensuring that strong PMMs operate on ISE.

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

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

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any 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

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

ISE 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 Number SR-ISE-2005-46 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-ISE-2005-46. 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 such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-ISE-2005-46 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.¹⁰

Jonathan G. Katz
Secretary

¹⁰ 17 CFR 200.30-3(a)(12).