

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-52910; File No. SR-ISE-2005-052)

December 7, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Requirements for Continued Approval of Securities that Underlie Options Traded on the Exchange.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 21, 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 and II below, which Items have been prepared by the ISE.<sup>3</sup> The ISE filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposal effective upon filing with the Commission. 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 proposes to amend certain of its rules governing the requirements for and the withdrawal of approval of securities underlying options traded on the Exchange. The text of the

---

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> In one part of the proposal, ISE Rule 504(d)(6) is erroneously referenced, instead of current ISE Rule 503(b)(6). The staff corrected this reference, as per telephone conversation between Samir Patel, Assistant General Counsel, ISE, and Christopher Chow, Attorney, Division of Market Regulation, Commission, December 5, 2005.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>5</sup> 17 CFR 240.19b-4(f)(6).

proposed rule change is below. Proposed new language is in italics; proposed deletions are in [brackets].

**Rule 502. Criteria for Underlying Securities**

- (a) Underlying securities with respect to which put or call options contracts are approved for listing and trading on the Exchange must meet the following criteria:
- (1) the security must be registered and be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Exchange Act [(i) listed on a national securities exchange; or (ii) traded through the facilities of a national securities association and reported as a “national market system” (“NMS”) security as set forth in Rule 11Aa3-1 under the Exchange Act]; and
- (2) No change.
- (b) – (j) No change.

**Rule 503. Withdrawal of Approval of Underlying Securities**

- (a) No change.
- (b) Absent exceptional circumstances, an underlying security will not be deemed to meet the Exchange’s requirements for continued approval whenever any of the following occur:
- (1) – (4) No change.
- [(5) The issuer has failed to make timely reports as required by applicable requirements of the Exchange Act, and such failure has not been corrected within thirty (30) days after the date the report was due to be filed.]
- [[6]] (5) The underlying security ceases to be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Exchange Act. [The issuer, in the case of an

underlying security that is principally traded on a national securities exchange, is delisted from trading on that exchange and neither meets NMS criteria nor is traded through the facilities of a national securities association, or the issue, in the case of an underlying security that is principally traded through the facilities of a national securities association, is no longer designated as an NMS security.]

[(7)] (6) If an underlying security is approved for options listing and trading under the provisions of Rule 502(c), the trading volume and price history of the Original Security (as therein defined) prior to but not after the commencement of trading in the Restructure Security (as therein defined), including “when-issued” trading, may be taken into account in determining whether the trading volume and market price requirements of (3) and (4) of this paragraph (b) are satisfied.

(c) – (j) No change.

\* \* \* \* \*

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. 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 eliminate ISE Rule 503(b)(5) pertaining to the continued approval of securities that underlie options traded on the Exchange. ISE Rule 503(b) sets forth various situations under which an underlying security previously approved for options trading will in usual circumstances be deemed to no longer meet Exchange requirements for the continuance of such approval. In such circumstances, ISE Rule 503(a) provides that the Exchange will not open for trading any additional series of options in that class and may also limit any new opening transactions in those options series that have already been opened.

Currently, ISE Rule 503(b)(5) provides that an underlying security will no longer be approved for options trading on the Exchange when:

“(5) The issuer has failed to make timely reports as required by applicable requirements of the Exchange Act, and such failure has not been corrected within thirty (30) days after the date the report was due to be filed.”

The Exchange proposes to eliminate this provision because (i) it limits investors' ability to use options to hedge existing equity positions in such securities, and (ii) it is not necessary in the context of the rest of ISE Rule 503(b).

First, ISE Rule 503(b)(5) can and does impact investors' interests by preventing investors from using new options series to hedge positions that they may hold in the underlying security of companies that fail to make timely reports required by the Act. ISE believes such a restriction is inconsistent with the rules and regulations in the markets for the underlying securities because no similar trading restriction is placed upon the trading of the underlying security itself. Thus, ISE Rule 503(b)(5) only serves to limit the abilities of shareholders in such companies who may wish

to hedge their positions with new options series, at a time when the ability to hedge may be particularly important.

ISE believes that ISE Rule 503(b)(5) has outlived any usefulness and now serves to unnecessarily burden and confuse the investing public. ISE believes this provision was appropriate when it was first implemented in or around 1976 when the listing and trading of standardized options was still in its infancy and information pertaining to public companies was not readily available to the general investing public. The Exchange believes that today's listed options market, however, is a mature one with investors who have access to a significant amount of real-time market information to assist them in making informed investment decisions, including information as to whether companies have timely filed reports as required by the Exchange Act, and if not, why not. Therefore, ISE believes that there is no reason to continue limiting investors' ability to trade in options classes, including new series within those classes, simply because a company is not timely in filing its reports. The Exchange further states that this restriction is further misplaced, considering that investors are not similarly restricted from buying or selling shares of the underlying security in the equity markets.

Moreover, the Exchange believes that ISE Rule 503(b)(5) limits an investor's ability to hedge his underlying stock positions at a time when he may be in most need to protect his investment. The failure of a public company to comply with its reporting requirements under the Act could cause a significant movement in the price of that company's stock. Restricting the Exchange from opening new options series may leave investors without means to hedge their positions with options contracts at strike prices that more accurately reflect the contemporaneous price trends of the underlying stock.

The ISE states that new options series on a security should not be permitted to be opened if the underlying security ceases to be an “NMS stock” within the meaning of Rule 600(b)(47) of Regulation NMS.<sup>6</sup> Typically, the Exchange becomes aware of issues that may impact the continued listing of a security well before that security is delisted from its primary market. Exchange staff routinely monitors daily press releases and informational releases disseminated by various entities, such as, the primary listing market of a security and private news services, in an effort to monitor the activities and news items pertaining to the issuers of securities that underlie options traded on the Exchange. In many cases, when an issuer fails to comply with its reporting requirements under the Act, the issuer is given a substantial amount of time to cure this deficiency before the primary listing market actually delists the issuer’s security. Many times, the issuer is able to comply without its security ever being delisted. During this period, ISE staff continually monitors the status of the issuer’s compliance with its reporting requirements to determine whether the security may be delisted. Finally, the primary listing market typically issues a press release well in advance of delisting an issuer’s security to give investors and other market participants adequate notice.

Given the availability of data and information relating to public issuers of securities in today’s markets, and in light of the extensive amount of additional continued listing standards under ISE Rule 503(b), waiting until a security is actually delisted by its primary listing market is the appropriate point at which to restrict the issuance of new options series in an options class. Accordingly, the Exchange hereby proposes to eliminate ISE Rule 503(b)(5).

---

<sup>6</sup> 17 CFR 242.600(b)(47).

Additionally, as a matter of “housekeeping,” the Exchange also proposes to clarify the texts of ISE Rules 502(a)(1) and 503(b)(6),<sup>7</sup> which govern the criteria for the initial and continued listing of options on a particular security, respectively. Both of these provisions include as part of the criteria, a requirement that the underlying security must be a national market system security (“NMS security”). As part of the recently adopted Regulation NMS,<sup>8</sup> among other things, the Commission revised the definition of an NMS security. Specifically, Rule 600(b)(46) under Regulation NMS defines an NMS security as “any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options.” As such, each of these ISE Rules will be amended to reflect these new terms.

## 2. Statutory Basis

The ISE believes that the basis under the Act for this proposed rule change is found in Section 6(b)(5), in that the elimination of ISE Rule 503(b)(5), which is both burdensome to investors and unnecessary for their protection, will serve to 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.

### B. Self-Regulatory Organization’s Statement on Burden on Competition

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

---

<sup>7</sup> ISE Rule 503(b)(6) would become ISE Rule 503(b)(5) to correspond with the elimination of current ISE Rule 503(b)(5), as discussed above.

<sup>8</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

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

The ISE has neither solicited nor received comments on the proposed rule change.

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

Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms does not become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(6) thereunder.

A proposed rule change filed under Rule 19b-4(f)(6) normally does not become operative for 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii) permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

The ISE has asked the Commission to waive the five-day pre-filing notice requirement and the 30-day operative delay. The Commission waives the five-day pre-filing notice requirement. Additionally, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because the proposed rule change is based upon a recently approved rule change by the Chicago Board Options Exchange,



Incorporated (“CBOE”),<sup>9</sup> which was published for notice and comment.<sup>10</sup> For this reason, the Commission designates that the proposal has become effective and operative immediately upon filing with the Commission.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>11</sup>

#### 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](mailto:rule-comments@sec.gov). Please include File No. SR-ISE-2005-052 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 20549-0903.

---

<sup>9</sup> See Securities Exchange Act Release Nos. 52562 (October 4, 2005), 70 FR 59382 (October 12, 2005) (notice for SR-CBOE-2004-037) and 52779 (November 16, 2005), 70 FR 70902 (November 23, 2005) (approval order for SR-CBOE-2004-037).

<sup>10</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>11</sup> See Rule 19b-4(f)(6)(iii), 17 CFR 240.19b-4(f)(6)(iii).

All submissions should refer to File No. SR-ISE-2005-052. 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 will also 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 No. SR-ISE-2005-052 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.<sup>12</sup>

Jonathan G. Katz  
Secretary

---

<sup>12</sup> 17 CFR 200.30-3(a)(12).