

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53127; File No. SR-ISE-2005-57)

January 13, 2006

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change and Amendment No. 1 Thereto Relating to Payment for Order Flow Fee Changes

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 December 1, 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 December 23, 2005, the ISE submitted Amendment No. 1 to the proposed rule change.³ The ISE has designated this proposal as one changing a fee imposed by the ISE under Section 19(b)(3)(A)(ii) of the Act⁴ and Rule 19b-4(f)(2) thereunder,⁵ which renders the proposal, as amended, 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1 ("Amendment No. 1"), the ISE: (1) eliminates the proposed \$450,000 per firm cap and keeps the current cap of \$450,000 per group of option classes; (2) states the procedures that Competitive Market Makers must follow in order to opt out of the payment for order flow program; (3) clarifies that the payment for order flow portion of the fee schedule will expire when the preferenced market maker program pilot program expires; (4) makes minor clarifications to the purpose section; (5) amends the rule text to conform it to the amended purpose section; and (6) makes technical corrections to the rule text.

⁴ 15 U.S.C. 78s(b)(3)(A)(ii).

⁵ 17 CFR 240.19b-4(f)(2).

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The ISE proposes to amend its payment for order flow program to allow preferenced Competitive Market Makers to administer payment for order flow fees collected by the Exchange.⁶

Below is the text of the proposed rule change, as amended. Proposed new language is underlined; proposed deletions are in [brackets].⁷

ISE Schedule of Fees

Electronic Market Place	Amount	Billable Unit	Frequency	Notes
Execution Fees				
* * * * *				
• Payment for Order Flow	\$0.55	Contract	Transaction	Applies to market makers only for each public customer contract executed; does not apply to Complex Orders; does not apply to the execution of a Public Customer Order by a Primary Market Maker if the Primary Market Maker executes a corresponding P/A trade on another exchange; does not apply to a market maker executing a Public Customer Order in the Price Improvement Mechanism; does not apply to transactions in HSX, OOG, BYT, HVY, RUF, JLO, SIN, RND, IXZ, IXX and IXK. The Payment for Order Flow Fee will be <u>rebated proportionately to the members that paid the fee</u> [suspended for a Group of options established under Rule 802(b) when] <u>such that on a quarterly basis the Payment for Order Flow fund balance administered by a Primary Market Maker</u> for [such Group

⁶ See Amendment No. 1, supra note 3.

⁷ Id.

reaches] a Group of options established under Rule 802(b) does not exceed \$450,000 and the Payment for Order Flow fund balance administered by a preferred Competitive Market Maker for such a Group does not exceed \$50,000[, and shall be reinstated when any such fund balance falls below \$450,000]. With respect to orders preferred to a Competitive Market Maker under Rule 713, a preferred Competitive Market Maker that elects not to administer a fund will not be charged the Payment for Order Flow fee. The Payment for Order Flow fee administered by preferred Competitive Market Makers, as described above, will be in effect until June 10, 2006, the date on which the Preferred Orders pilot program expires.

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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, as amended, 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 payment for order flow program to allow preferred Competitive Market Makers to administer payment for order flow fees collected by the Exchange. The Commission recently approved the Exchange's proposed rule change to permit

Electronic Access Members (EAMs) to “preference” their order flow to specified market makers.⁸ The Exchange states that, under this rule, if a preferenced market maker, which could be either a Primary Market Maker (PMM) or a Competitive Market Maker (CMM), is quoting at the national best bid or offer when ISE receives a preferenced order, that market maker receives an enhanced allocation of the order. The Exchange also operates a payment for order flow (“PFOF”) program as approved by the Commission.⁹ The Exchange states that this program is funded through a fee paid by Exchange market makers for each customer contract they execute. The Exchange represents that, currently, all funds collected by the Exchange are administered by the PMM for their group (or “bin”) of options classes.

The Exchange proposes to amend its PFOF program to allow a CMM to administer the PFOF funds collected by the Exchange with respect to orders preferenced to it in a group of options classes.¹⁰ Each CMM pool would have a ceiling of \$50,000.¹¹ Preferenced CMMs would be able to choose not to administer PFOF pools, in which case the PFOF fee collected by the Exchange would go into the PFOF fund administered by the PMM in the group of options as

⁸ See Exchange Act Release No. 51818 (June 10, 2005), 70 FR 35146 (June 16, 2005) (SR-ISE-2005-18).

⁹ See Exchange Act Release No. 43833 (January 10, 2001), 66 FR 7822 (January 25, 2001) (SR-ISE-2000-10).

¹⁰ As is the case with the PFOF funds administered by the PMM, the PFOF fee collected on a preferenced order would be administered by the preferenced CMM whether or not the CMM was a party on a particular trade.

¹¹ In order to accommodate the introduction of the preferenced CMM PFOF pools each having a \$50,000 ceiling in addition to the existing PMM PFOF fund that has a \$450,000 ceiling, the Exchange will rebate back to members any balance of a fund that exceeds the applicable ceiling for a particular PFOF fund on a quarterly basis.

it would have had the order not been preferenced to the CMM.¹² A CMM will not be charged the PFOF fee for orders preferenced to it if it determines not to administer PFOF pools.¹³

2. Statutory Basis

The Exchange believes that its proposal, as amended, is consistent with Section 6(b) of the Act¹⁴ in general, and furthers the objectives of Section 6(b)(4) of the Act¹⁵ in particular, in that it is an equitable allocation of reasonable dues, fees, and other charges among ISE members and other persons using its facilities.

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

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

¹² CMMs must notify the Exchange if they elect to opt-out of the proposed payment for order flow fee program in writing no later than five business days prior to the end of the month for which the payment for order flow fee is to be assessed. Once an election not to participate has been made by a CMM, no notice to the Exchange is required in subsequent months unless there is a change in participation status.

¹³ The Exchange states that the proposed rule change would be in effect until June 10, 2006, the date on which the Preferenced Orders pilot program expires. See Exchange Act Release No. 52066 (July 20, 2005), 70 FR 43479 (July 27, 2005) (SR-ISE-2005-35). The Exchange notes that allowing a preferenced CMM to administer the PFOF fees collected by the Exchange with respect to preferenced orders is similar to the Philadelphia Stock Exchange's PFOF program. See Exchange Act Release No. 52568 (October 6, 2005), 70 FR 60120 (October 14, 2005) (SR-Phlx-2005-58).

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(4).

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

The foregoing proposed rule change, as amended, has been designated as a fee change pursuant to Section 19(b)(3)(A)(ii) of the Act¹⁶ and Rule 19b-4(f)(2)¹⁷ thereunder, because it establishes or changes a due, fee, or other charge imposed by the Exchange. Accordingly, the proposal will take effect upon filing with the Commission. At any time within 60 days of the filing of such proposed rule change, as amended, 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.¹⁸

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:

¹⁶ 15 U.S.C. 78s(b)(3)(A)(ii).

¹⁷ 17 CFR 240.19b-4(f)(2).

¹⁸ The effective date of the original proposed rule change is December 1, 2005, and the effective date of Amendment No. 1 is December 23, 2005. For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposal, the Commission considers the period to commence on December 23, 2005, the date on which the Exchange submitted Amendment No. 1.

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-2005-57 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-ISE-2005-57. 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, as amended, 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-2005-57 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.¹⁹

Nancy M. Morris
Secretary

¹⁹ 17 CFR 200.30-3(a)(12).