

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46197; File No. SR-ISE-2002-13]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by International Securities Exchange, Inc., Relating to Limit Orders for the Account of Options Market Makers From Other Exchanges

July 12, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 16, 2002, the International Securities Exchange, Inc. ("ISE") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II, and III below, which the ISE has prepared. 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 to provide that limit orders entered for the account of options market makers from other exchanges must be designated as immediate-or-cancel ("IOC") orders.

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 had 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 those statements.

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

ISE rules permit Electronic Access Members ("EAMs") to enter limit orders for the account of an options market maker on another exchange. Limit orders that are IOC orders trade immediately, with any unexecuted size being cancelled. In contrast, any unexecuted size associated with a limit order not designated as IOC is placed on

the ISE's limit order book to be displayed in the same manner as customer orders, ISE member proprietary orders, and ISE market maker quotes. Once on the ISE's limit order book, orders for the accounts of such non-ISE options market makers are given equal allocation rights as other proprietary broker-dealer orders and ISE market maker quotes and orders. The purpose of this proposed rule change is to provide that limit orders entered for the account of options market makers from other exchanges must be designated as IOC orders.

As a general matter, the ISE affords market makers on other exchanges greater access to the ISE market than the other exchanges provide for ISE market makers. For example, most other exchanges do not permit ISE market makers to place orders on their limit order books.³ Moreover, no other options exchange allows ISE market makers to be on the "wheel," and thus to participate in transactions effected in their automated execution systems. This is in marked contrast to the ISE, where market makers from other exchanges directly compete for order flow with ISE market makers. The ISE believes that this puts ISE market makers at a competitive disadvantage. According to the ISE, moreover, when ISE market makers trade against customer orders, they are subject to payment-for-order-flow and marketing fees that do not apply to their competitors. The ISE's proposed rule filing is designed to address these concerns.⁴

The basis for this proposed rule change is the requirement under section 6(b)(5) under the Exchange Act⁵ that an Exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

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 that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

³ See, e.g., Chicago Board Options Exchange Rules 6.2A(a)(ii), 6.45 and 8.85.

⁴ The ISE believes that this proposal is fully consistent with the provisions of the intermarket linkage, now in development. Specifically, that linkage would permit only market makers to send IOC orders to another exchange. See Plan for the Purpose of Creating and Operating an Intermarket Option Linkage, Section 2(16), which defines a "Linkage Order" solely as an IOC order.

⁵ 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

The ISE has not solicited, and does not intend to solicit, comments on this proposed rule change. The ISE 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 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to SR-ISE-2002-13 and should be submitted by August 9, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland,
Deputy Secretary.

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

⁶ 17 CFR 200.30-3(a)(12).