

and, therefore, has become effective immediately pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>8</sup> and Rule 19b-4(f)(2) thereunder.<sup>9</sup> At any time within 60 days of the filing of such 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.

#### 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 Section. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer File No. SR-ISE-2003-12 and should be submitted by April 16, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47532; File No. SR-ISE-2001-15]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the International Securities Exchange LLC Relating to a Pilot Program for Quotation Spreads

March 19, 2003.

#### I. Introduction

On May 25, 2001, the International Securities Exchange LLC ("ISE" or "Exchange"), filed with the Securities and Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change to amend Supplementary Material .01 to ISE Rule 803, "Obligations of Market Makers," to establish a six-month pilot program in which the allowable quotation spread for options on up to 50 underlying securities (the "Pilot Options") will be \$5, regardless of the price of the bid.<sup>3</sup>

The proposed rule change was published for comment in the **Federal Register** on November 27, 2002.<sup>4</sup> No comments were received regarding the proposal. This order approves the proposed rule change.

#### II. Description

Currently, the ISE's rules contain maximum quotation spread requirements that generally vary from \$.25 to \$1, depending on the price of the option. Specifically, ISE Rule 803(b)(4) requires options market makers to bid and offer so as to create differences of no more than \$.25 between the bid and offer for each options contract for which the bid is less than \$2; no more than \$.40 where the bid is at least \$2 but does not exceed \$5; no more than \$.50 where the bid is more than \$5 but does not exceed \$10; no more than \$.80 where the bid is more than \$10 but does not exceed \$20; and no more than \$1 where the bid is \$20 or greater. The bid/offer differentials do not apply to in-the-money options series when the spread in the underlying securities market is wider than the differentials set forth

above. For such series, ISE Rule 803(b)(4) permits the bid/ask differential to be as wide as the quotation on the primary market of the underlying security.

The ISE proposes to expand the allowable spread to \$5 in up to 50 Pilot Options (up to five per each of the ISE's ten options bins). The ISE represents that it will monitor the quotation quality of the Pilot Options for a six-month pilot period and, based on the results, recommend either relaxing the spread requirements for all options, ending the pilot, or adjusting the spread requirements.

#### III. Discussion

The Commission finds that, due to the ISE's market structure, discussed in greater detail below, the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>5</sup> Specifically, the Commission finds that the proposal, which will allow ISE market makers to widen their quotations for Pilot Options when they believe that market conditions require wider spreads, is consistent with section 6(b)(5) of the Act<sup>6</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

The Commission believes generally that maximum quotation spread parameters in the options market are important safeguards to ensure that market maker quotes in options are not unnecessarily wide. The Commission nevertheless believes that the ISE provides sufficiently strong incentives for market makers to disseminate competitive quotes without maximum quotation spread parameters. Specifically, each ISE market maker uses an automatic quotation system to quote independently, customers and professional traders can enter limit orders on the ISE's book, and market makers are only allocated trades when they are quoting at the best price. Moreover, the larger the size of a market maker's quote, the larger portion of a trade it is allocated. The Commission believes that these attributes and rules of the ISE provide strong market incentives for market makers to

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

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

<sup>3</sup> The ISE's pilot program will include only equity options and not index options. Telephone conversation between Mike Simon, Senior Vice President and General Counsel, ISE, and Yvonne Fraticelli, Special Counsel, Division of Market Regulation ("Division"), Commission, on February 25, 2003.

<sup>4</sup> See Securities Exchange Act Release No. 46860 (November 20, 2002), 67 FR 70988.

<sup>5</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>9</sup> 17 CFR 19b-4(f)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

maintain narrow and competitive quotation spreads. Consequently, the Commission believes that the ISE's proposal to establish a \$5 maximum spread on a pilot basis in 50 options classes is consistent with the Act.

The ISE is implementing the proposal on a six-month pilot basis. Prior to the conclusion of the pilot program, the ISE has agreed to submit a report to the Commission assessing the operation of the pilot program and, in particular, the quality of the quotations for the Pilot Options.<sup>7</sup> The report will include: (1) The identity of the Pilot Options; (2) information concerning the frequency with which quotations for the Pilot Options were narrower than the current quote spread parameters for options at that price, at the current quote spread parameters for options at that price, and wider than the current quote spread parameters for options at that price; (3) the average quotation spread for each Pilot Option during each month of the pilot program; (4) the widest and narrowest quote spreads for each Pilot Option during each month of the pilot program; (5) any problems that developed during the pilot program and how the ISE addressed those problems; and (6) any additional information that would help the Commission assess the pilot program.

#### IV. Conclusion

For the foregoing reasons, the Commission finds that the proposal is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-ISE-2001-15) is approved as a six-month pilot program to expire on September 19, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47538; File No. SR-ISE-2003-09]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by International Securities Exchange, Inc., Relating to Limiting the Liability of Index Licensors for Options on Fund Shares

March 19, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on March 12, 2003, the International Securities Exchange, Inc. ("ISE" or "Exchange") submitted to 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 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 ISE is proposing to limit the liability of index licensors who grant the ISE a license to use their underlying indexes or portfolios in connection with the trading of options on Fund Shares. The text of the proposed rule change appears below. Proposed new language is *italicized*.

\* \* \* \* \*

*Rule 507. Limitation on the Liability of Index Licensors for Options on Fund Shares.*

*(a) The term "index licensor" as used in this Rule refers to any entity that grants the Exchange a license to use one or more indexes or portfolios in connection with the trading of options on Fund Shares (as defined in rule 502(h)).*

*(b) No index licensor with respect to any index or portfolio underlying an option on Fund Shares traded on the Exchange makes any warranty, express or implied, as to the results to be obtained by any person or entity from the use of such index or portfolio, any opening, intra-day or closing value therefor, or any data included therein or relating thereto, in connection with the trading of any option contract on Fund Shares based thereon or for any other purpose. The index licensor shall obtain information for inclusion in, or for use in the calculation of, such index or*

*portfolio from sources it believes to be reliable, but the index licensor does not guarantee the accuracy or completeness of such index or portfolio, any opening, intra-day or closing value therefor, or any data included therein or related thereto. The index licensor hereby disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to any such index or portfolio, any opening, intra-day or closing value therefor, any data included therein or relating thereto, or any option contract on Fund Shares based thereon. The index licensor shall have no liability for any damages, claims, losses (including any indirect or consequential losses), expenses or delays, whether direct or indirect, foreseen or unforeseen, suffered by any person arising out of any circumstance or occurrence relating to the person's use of such index or portfolio, any opening, intra-day or closing value therefor, any data included therein or relating thereto, or any option contract on Fund Shares based thereon, or arising out of any errors or delays in calculating or disseminating such index or portfolio.*

\* \* \* \* \*

#### 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 ISE proposes to limit the liability of index licensors who grant the ISE a license to use their underlying indexes or portfolios in connection with the trading of options on Fund Shares. The ISE recently entered into a license agreement with an index licensor, and that agreement calls for the ISE to adopt a rule limiting the index licensor's liability. This proposed rule is

<sup>7</sup> Telephone conversation between Mike Simon, Senior Vice President and General Counsel, ISE, and Yvonne Fraticelli, Special Counsel, Division, Commission, on March 19, 2003.

<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).

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

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