

monitoring, such Members may also be placed on the "watch list" if they experience a financial change that presents risk to FICC. Some examples include failure to meet minimum financial requirements or experiencing a significant decrease in equity (for GSD members) or net asset value (for MBSD members). Members placed on the "watch list" in this way will also be monitored more closely by credit risk staff.

The GSD will continue, in accordance with its current procedures, to place GSD netting members on the "watch list" for failure to comply with operational standards and requirements.⁸ MBSD expects to implement a similar provision, as outlined in these rule changes, soon.

III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to facilitate the safeguarding of securities and funds which are in its custody or control or for which it is responsible.⁹ The Commission finds that FICC's proposed rule change is consistent with this requirement because it will improve FICC's member surveillance process which will better enable FICC to safeguard the securities and funds which are in its custody or control or for which it is responsible.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular section 17A of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (File No. SR-FICC-2003-03) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Jill M. Peterson,

Assistant Secretary.

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⁸ The GSD currently monitors the comparison rates of members. Currently, low comparison rates can result in a member being placed on Class 1 surveillance status. Under the rule change, low comparison rates may result in a GSD member being placed on the "watch list." Both the GSD and the MBSD may monitor for other operational factors in the future such as failing to timely submit trade data on a frequent basis.

⁹ 15 U.S.C. 78q-1(b)(3)(F).

¹⁰ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49141; File No. SR-ISE-2001-22]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto by the International Securities Exchange, Inc., To Establish a Solicited Order Mechanism

January 28, 2004.

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 July 26, 2001, 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 January 4, 2002, ISE filed Amendment No. 1 to the proposed rule change.³ On June 26, 2002, ISE filed Amendment No. 2 to the proposed rule change.⁴ On January 6, 2004, ISE filed Amendment No. 3 to the proposed rule change.⁵ 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 is proposing to amend its rules regarding solicited orders to establish a Solicited Order Mechanism for matching a member's unsolicited agency orders with orders the member solicits from other broker-dealers. The text of the proposed rule change, as amended, is set forth below. Brackets indicate material to be deleted. *Italics* indicate material to be added.

Rule 716. Block and Solicited Trades

* * * * *

(e) Solicited Order Mechanism. The Solicited Order Mechanism is a process

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated January 3, 2002.

⁴ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated June 25, 2002.

⁵ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated January 5, 2004. Amendment No. 3 replaced the initial filing and Amendment Nos. 1 and 2 entirely. The changes proposed in Amendment No. 3 are incorporated in this notice.

by which an Electronic Access Member can attempt to execute orders of 500 or more contracts it represents as agent (the "Agency Order") against contra orders that it solicited. Each order entered into the Solicited Order Mechanism shall be designated as all-or-none.

(1) Upon entry of both orders into the Solicited Order Mechanism at a proposed execution price, a broadcast message will be sent to Crowd Participants, which will be given an opportunity to enter Responses with the prices and sizes at which they would be willing to participate in the execution of the Agency Order.

(2) At the end of the period given Crowd Participants to enter Responses, the Agency Order will be automatically executed in full or cancelled.

(i) If at the time of execution there is insufficient size to execute the entire Agency Order at an improved price (or prices), the Agency Order will be executed against the solicited order at the proposed execution price so long as, at the time of execution: (A) the execution price is equal to or better than the best bid or offer on the ISE, and (B) there are no Public Customer orders on the Exchange that are priced equal to the proposed execution price. If there are Public Customer orders on the Exchange on the opposite side of the Agency Order at the proposed execution price and there is sufficient size to execute the entire size of the Agency Order, the Agency Order will be executed against the bid or offer, and the solicited order will be cancelled. The aggregate size of all orders, quotes and Responses at the bid or offer will be used to determine whether the entire Agency Order can be executed. Both the solicited order and Agency Order will be cancelled if an execution would take place at a price that is inferior to the best bid or offer on the ISE, or if there is a Public Customer on the book at the proposed execution price but there is insufficient size on the Exchange to execute the entire Agency Order.

(ii) If at the time of execution there is sufficient size to execute the entire Agency Order at an improved price (or prices), the Agency Order will be executed at the improved price(s), subject to the condition in (i)(A), and the solicited order will be cancelled. The aggregate size of all orders, quotes and Responses at each price will be used to determine whether the entire Agency Order can be executed at an improved price (or prices).

(iii) When executing the Agency Order against the bid or offer in accordance with paragraph (i) above, or at an improved price in accordance with

paragraph (ii) above, Public Customer orders will be executed first. Non-Customers participate in the execution of the Agency Order based upon the percentage of the total number of contracts available at the best price that is represented by the size of the Non-Customer interest.

(3) Prior to entering Agency Orders into the Solicited Order Mechanism on behalf of a customer, EAMs must deliver to the customer a written notification informing the customer that its order may be executed using the ISE's Solicited Order Mechanism. Such written notification must disclose the terms and conditions contained in this Rule and must be in a form approved by the Exchange.

Supplementary Material to Rule 716

.02 The time given to Crowd Participants to enter Responses under paragraph (c)(1) shall be thirty (30) seconds[.]. The time given to Crowd Participants to enter [and for] Indications [entered] under paragraph (d)(1) and Responses under paragraph (e)(1) shall be ten (10) seconds.

.03 Under paragraph (e) above, Members may enter contra orders that are solicited. The Solicited Order Mechanism provides a facility for Members that locate liquidity for their customer orders. Members may not use the Solicited Order Mechanism to circumvent Exchange Rule 717(d) limiting principal transactions. This may include, but is not limited to, Members entering contra orders that are solicited from (1) affiliated broker-dealers, or (2) broker-dealers with which the Member has an arrangement that allows the Member to realize similar economic benefits from the solicited transaction as it would achieve by executing the customer order in whole or in part as principal.

Rule 717. Limitations on Orders

* * * * *

(e) Solicitation Orders.

Electronic Access Members [must expose] may not execute orders they represent as agent on the Exchange [for at least thirty (30) seconds before such orders may be executed in whole or in part by] against orders solicited from Members and non-member broker-dealers to transact with such orders unless (i) the unsolicited order is first exposed on the Exchange for at least thirty (30) seconds, or (ii) the Member utilizes the Solicited Order Mechanism pursuant to Rule 716(e).

* * * * *

Rule 400. Just and Equitable Principles of Trade

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Supplemental Material to Rule 400

.02 It may be considered conduct inconsistent with just and equitable principles of trade for any person associated with a Member who has knowledge of all material terms and conditions of:

- (i) An order and a solicited order,
- (ii) An order being facilitated, or
- (iii) Orders being crossed;

the execution of which are imminent, to enter, based on such knowledge, an order to buy or sell an option for the same underlying security as any option that is the subject of the order, or an order to buy or sell the security underlying such class, or an order to buy or sell any related instrument until (i) the terms of the order and any changes in the terms of the order of which the person associated with the Member has knowledge are disclosed to the trading crowd, or (ii) the trade can no longer reasonably be considered imminent in view of the passage of time since the order was received. The terms of an order are "disclosed" to the trading crowd on the Exchange when the order is entered into the System, [or into] the Facilitation or Solicited Order Mechanisms.

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 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

Under ISE Rule 717(e), an Electronic Access Member ("EAM") is required to expose an unsolicited agency order (the "Agency Order") for at least 30 seconds before crossing it against an order that it has solicited from other broker-dealers. Currently, an EAM can comply with this requirement only by entering the Agency Order on the Exchange, waiting 30 seconds, and then entering the solicited order. The Exchange states

that, due to this 30-second exposure requirement, EAMs have no level of assurance that they will be able to pair solicited orders against Agency Orders for execution, and thus they take this type of business to the other options exchanges, which permit these trades to be executed without a 30-second exposure requirement.⁶

To better compete for solicited transactions, the ISE has developed a Solicited Order Mechanism. The proposed rule change would implement this functionality, allowing EAMs to enter both sides of a proposed solicited cross, where one of the sides was solicited.⁷ Such trades would be required to be for at least 500 contracts and would be executed only if the price is at or between the ISE best bid or offer ("BBO"). Both orders entered into the Solicited Order Mechanism would be required to be all-or-none limit orders.

When a proposed solicited cross is entered into the Mechanism, the Exchange would send a message to the Crowd Participants,⁸ giving them ten seconds to respond with a price that would improve the execution price for the Agency Order.⁹ The proposed matched trade will be executed unless there is sufficient size to execute the entire Agency Order at a better price than the proposed cross price, or there is a Public Customer order on the book at the proposed cross price. In the case where there is one or more Public Customer orders on the book at the proposed execution price on the opposite side of the Agency Order, the

⁶ See Commentary .03 to American Stock Exchange Rule 950(d); Chicago Board Options Exchange Rule 6.9; Pacific Exchange Rule 6.49; and Philadelphia Stock Exchange Rule 1064(c).

⁷ Although orders solicited from public customers are not subject to the exposure requirement of Rule 717(a), they would be permitted to be entered into the Solicited Order Mechanism should Exchange members choose this alternative.

⁸ In another proposed rule change on file with the Commission, the Exchange proposes to allow all members, rather than the more limited Crowd Participants, to participate in Block and Facilitation Mechanism trades. See Securities Exchange Act Release No. 49056 (January 12, 2004), 69 FR 2798 (January 20, 2004) (concerning File No. SR-ISE-2003-07). The Exchange notes that if that proposal is approved prior to the approval of the instant proposed rule change, the Exchange will amend the instant proposed rule change so that all members may similarly participate in trades executed through the Solicited Order Mechanism.

⁹ The ISE notes that the Commission previously determined that a ten second exposure period in the ISE's electronic marketplace is sufficient to provide participants with an opportunity to respond to orders entered into the Facilitation Mechanism. See Securities Exchange Act Release No. 46514 (September 18, 2002), 67 FR 60267 (September 25, 2002). The ISE states that the same technology would be used by the Solicitation Mechanism, and members would be able to respond in exactly the same manner as they do to orders executed through the Facilitation Mechanism.

Agency Order would be executed against the book if there is sufficient size available at the bid or offer to execute the entire size of the Agency Order.¹⁰ If there is insufficient size to execute the entire Agency Order, the proposed cross would not be executed and would be cancelled. Similarly, the transaction would be cancelled if the execution price would be inferior to the BBO on the Exchange.

The proposed rule also would require members to deliver to customers a written document describing the terms and conditions of the Solicited Order Mechanism prior to executing Agency Orders using the Solicited Order Mechanism. Such written document would be required to be in a form approved by the Exchange.

Finally, the proposed rule change specifies in new Supplemental Material to Rule 716 that members would be prohibited from using the Solicited Order Mechanism to circumvent Rule 717(d) limiting principal transactions. The proposed rule change also adds a reference to the Solicited Order Mechanism in the Supplemental Material to Rule 400 (Just and Equitable Principles of Trade) that prohibits anticipatory hedging activities prior to the entry of an order on the Exchange.

2. Statutory Basis

The basis under the Act for the proposed rule change is the requirement under section 6(b)(5) of the Act¹¹ that an exchange have rules that are 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest. The Exchange states that the implementation of the Solicited Order Mechanism will allow the Exchange to better compete for solicited transactions, while providing an opportunity for price improvement for Agency Orders and assuring that public customers on the book are protected.

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

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

¹⁰ When the Agency Order is executed at an improved price or at the proposed execution price against the book, Public Customer orders are given priority in the execution, and then all other non-professional interest at the same price would participate pro-rata based on size.

¹¹ 15 U.S.C. 78f(b)(5).

The proposed rule change will allow the Exchange to better compete for solicited transactions.

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

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 Exchange 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. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comment letters should refer to File No. SR-ISE-2001-22. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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 offices of the ISE. All submissions should refer to File No. SR-ISE-2001-22 and should be submitted by February 26, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Jill M. Peterson,

Assistant Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49149; File No. SR-ISE-2004-02]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the International Securities Exchange, Inc. Relating to the Extension of the Pilot Program for Quotation Spreads

January 29, 2004.

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 January 22, 2004, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in items I and II below, which items have been prepared by the ISE. The proposed rule change has been filed by the ISE under Rule 19b-4(f)(6) of the Act.³ 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 extend until March 31, 2004, a pilot program permitting the allowable quotation spread for options on up to 50 equity securities to be \$5, regardless of the price of the bid ("Pilot Program"). The ISE proposes no substantive changes to the Pilot Program other than extending its operation through March 31, 2004. Pursuant to Rule 19b-4(f)(6) under the Act, the ISE requests that the Commission waive the 30-day pre-operative requirement contained in Rule 19b-4(f)(6)(iii).⁴

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

⁴ 17 CFR 240.19b-4(f)(6)(iii).