

Because the longer exposure period introduces unnecessary market risk to orders entered into the Block Order Mechanism, the Exchange proposes to reduce the Block Order Mechanism exposure period to three seconds.

2. Statutory Basis

The basis under the Act for this proposed rule change is found in Section 6(b)(5),⁶ in that the proposed rule change is designed to promote just and equitable principles of trade, 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. In particular, the proposed rule change will reduce unnecessary market risk for orders entered into the Block Order Mechanism.

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

The proposed rule change does not impose any burden on competition.

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 written comments from members or other interested parties.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act⁷ and Rule 19b-4(f)(6) thereunder.⁸

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.

A proposed rule change filed under Rule 19b-4(f)(6) normally may not become operative prior to 30 days after

the date of filing.⁹ However, Rule 19b-4(f)(6)(iii)¹⁰ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The ISE provided the Commission with written notice of its intent to file this proposed rule change at least five business days prior to the date of filing of the proposed rule change. In addition, the ISE has requested that the Commission waive the 30-day operative delay. The Commission has previously stated its belief that in an electronic environment—such as that of the ISE options market—reducing the exposure period for orders to three seconds could facilitate the prompt execution of such orders, while providing market participants with an adequate opportunity to compete for them.¹¹ Thus, the Commission believes that waiving the 30-day operative delay for the instant proposed rule change is consistent with the protection of investors and the public interest. For this reason, the Commission designates the proposal to be effective and operative immediately.¹²

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. Please include File Number SR-ISE-2006-52 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 20549-1090.

All submissions should refer to File Number SR-ISE-2006-52. This file number should be included on the subject line if e-mail is used. To help the

⁹ 17 CFR 240.19b-4(f)(6)(iii).

¹⁰ *Id.*

¹¹ See, e.g., Securities Exchange Act Release Nos. 52711 (November 1, 2005), 70 FR 67508 (November 7, 2005) (SR-ISE-2004-04); 53384 (February 27, 2006), 71 FR 11280 (March 6, 2006) (SR-PCX-2005-135); and 53567 (March 29, 2006), 71 FR 17529 (April 6, 2006) (SR-CBOE-2006-09).

¹² 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. See 15 U.S.C. 78c(f).

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 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-2006-52 and should be submitted on or before October 25, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Nancy M. Morris,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54528; File No. SR-ISE-2006-48]

Self-Regulatory Organizations; International Securities Exchange, Inc. (n/k/a International Securities Exchange, LLC); Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto Relating to the Adoption of Rules To Govern Its Electronic Trading System for Equities

September 28, 2006.

I. Introduction

On August 4, 2006, the International Securities Exchange, Inc. (n/k/a International Securities Exchange, LLC) ("ISE" or "Exchange")¹ filed with the

¹³ 17 CFR 200.30-3(a)(12).

¹ On September 1, 2006, the Exchange adopted a holding company structure by forming a new parent company, International Securities Exchange

⁶ 15 U.S.C. 78f(b)(5).

⁷ 15 U.S.C. 78s(b)(3)(A).

⁸ 17 CFR 240.19b-4(f)(6).

Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")² and Rule 19b-4 thereunder,³ to adopt rules to govern its electronic trading system for equity securities. The proposed rule change was published for comment in the **Federal Register** on August 15, 2006.⁴ The Commission received no comments on the proposal. On September 27, 2006, the Exchange filed Amendment No. 1 to the proposal.⁵ This order approves the proposed rule change, grants accelerated approval to Amendment No. 1, and solicits comments from interested persons on Amendment No. 1.

II. Summary Description of the Proposal

The Exchange proposes to adopt new rules and amend existing ISE rules to govern the operation of the ISE Stock Exchange, LLC ("ISE Stock Exchange"), a new electronic trading system for

Holdings, Inc. ("Holdings"). As part of the restructuring, International Securities Exchange, Inc. ("ISE Inc."), the registered national securities exchange, merged into a newly formed entity, International Securities Exchange, LLC ("ISE LLC"), a wholly-owned subsidiary of Holdings. ISE LLC continues to conduct the business operations of the exchange and is the successor to the registration of ISE Inc. as a national securities exchange. See Securities Exchange Act Release No. 53705 (April 21, 2006), 71 FR 25260 (April 28, 2006) (File No. SR-ISE-2006-04). Holdings is also the parent company of ISE Stock Exchange, LLC, the facility to which the proposed rule change relates. All references herein to "ISE" or the "Exchange" refer to ISE Inc. or ISE LLC, as appropriate.

² 15 U.S.C. 78s(b)(1).

³ 17 CFR 240.19b-4.

⁴ See Securities Exchange Act Release No. 54287 (August 8, 2006), 71 FR 46947.

⁵ In Amendment No. 1, the Exchange: (i) amended proposed ISE Rule 2110 (Minimum Price Variation) to conform with the language of Rule 612 of Regulation NMS; (ii) amended proposed ISE Rule 2106 (Opening Process) to reflect all order types that cannot participate in the opening process and to add a provision addressing closing procedures; (iii) changed the term "partial round lot" to "mixed lots" to correspond to the current industry term and clarified corresponding proposed ISE Rule 2105 (Order Entry); (iv) amended proposed ISE Rule 2107 (Priority and Execution of Orders) to address how orders entered into the ISE Stock Exchange will interact with MidPoint Match orders; (v) amended proposed ISE Rule 2118 (Trade Modifiers) to incorporate applicable requirements of Rule 611 of Regulation NMS; (vi) made clarifying changes to the clearing requirements; (vii) made conforming changes to the proposed rules to match, where applicable, the rules filed under the Form PILOT relating to MidPoint Match; (viii) added proposed ISE Rule 2120 (Taking or Supplying Securities); (ix) clarified routing procedures before and after February 5, 2007, the Regulation NMS "Trading Phase Date"; and (x) made other minor clarifying changes to various proposed rules. The complete text of Amendment No. 1 is available on the Commission's Web site (<http://www.sec.gov/rules/sro.shtml>), at the Commission's Public Reference Room, and at the Exchange.

equity securities ("System").⁶ In addition, the Exchange proposes to apply certain of its options rules to the trading of equity securities on the ISE Stock Exchange. The ISE Stock Exchange will trade equity securities only pursuant to unlisted trading privileges ("UTP").⁷

The System will provide for the electronic execution and display of orders, as well as a midpoint matching feature ("MidPoint Match"). The class of members who will be eligible to trade on the ISE Stock Exchange are electronic access members ("EAMs") of the Exchange whom ISE specifically authorizes to trade on the ISE Stock Exchange ("Equity EAMs"). Orders will be ranked in the System based on price-time priority, regardless of the identity of the entering Equity EAM. Executions will take place automatically and immediately upon order entry if trading interest is available. The System will provide a routing service for orders when trading interest is not present on the ISE Stock Exchange. The ISE Stock Exchange will not have any market makers, only Equity EAMs who will provide liquidity to the ISE Stock Exchange. The ISE Stock Exchange will be an order-driven marketplace.

The proposed rules incorporate the ISE Stock Exchange's compliance with Rule 611 of Regulation NMS⁸ by requiring that, for any execution to occur on the ISE Stock Exchange during regular trading hours, the price must be equal to, or better than, any "protected quotation" within the meaning of Regulation NMS ("Protected Quotation"),⁹ unless an exception to Rule 611 of Regulation NMS is available.¹⁰ The Exchange proposes to direct to away markets for execution all or a portion of the orders that cannot be executed at the Protected Quotation on the ISE Stock Exchange, and are not cancelled.¹¹ The proposed rules also

⁶ On September 1, 2006, the Commission approved a proposed rule change establishing the ISE Stock Exchange as a "facility," as defined in Section 3(a)(2) of the Act, of the Exchange. See Securities Exchange Act Release No. 54399, 71 FR 53728 (September 12, 2006) (SR-ISE-2006-45).

⁷ While the proposed rules would allow the ISE Stock Exchange to trade common stock, Commodity-Based Trust Shares, Currency Trust Shares, Partnership Units, Trust Issued Receipts including those based on Investment Shares, and Investment Company Units by either listing and/or trading pursuant to UTP, the Commission notes that, to list equity securities, the Exchange would need to amend its rules to comply with Rule 10A-3 under the Act, 17 CFR 240.10A-3, and to incorporate qualitative listing criteria by filing a proposed rule change under Section 19(b)(1) of the Act.

⁸ 17 CFR 242.611.

⁹ See proposed ISE Rule 2100(c)(16).

¹⁰ See proposed ISE Rule 2107(c).

¹¹ See proposed ISE Rule 2107(d).

incorporate the prohibition in Regulation NMS on locking or crossing Protected Quotations,¹² except in certain circumstances.¹³

The MidPoint Match feature of the System will be a mechanism for trading equity securities in a continuous matching system.¹⁴ Users will enter unpriced orders into MidPoint Match, and MidPoint Match will continuously monitor buy and sell orders in MidPoint Match and, subject to certain limitations discussed more fully below, will execute orders at the midpoint of the NBBO when interest is resident in MidPoint Match on both sides of the market.¹⁵

A more complete discussion of the features of the ISE Stock Exchange is contained below.

III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations promulgated thereunder applicable to a national securities exchange¹⁶ and, in particular, with the requirements of Section 6(b) of the Act.¹⁷ Specifically, the Commission finds that approval of the proposed rule change is consistent with Section 6(b)(5) of the Act¹⁸ in that it is designed to facilitate transactions in securities; to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions

¹² 17 CFR 242.610(d).

¹³ See proposed ISE Rule 2112.

¹⁴ See proposed ISE Rule 2129.

¹⁵ The Exchange previously filed with the Commission pursuant to Rule 19b-5 under the Act, 17 CFR 240.19b-5, a Form PILOT setting forth rules governing MidPoint Match. See PILOT-ISE-2006-01 (July 28, 2006). ISE commenced operation of MidPoint Match on September 8, 2006. The rules filed under the Form PILOT, with minor modifications, were incorporated into the Exchange's proposed rule change, as amended. Upon the Commission's approval of the proposed rule change, the rules relating to the fully displayed market will be effective, but will not be operative until ISE launches its fully displayed market, and the rules pertaining to MidPoint Match that are incorporated into the proposed rule change will be operative immediately. Prior to launch of the fully displayed market, the Exchange intends to file a proposed rule change with the Commission to indicate that the rules relating to the fully displayed market have become operative. The Exchange represents that it intends to commence trading in the displayed market prior to February 5, 2007, the Regulation NMS "Trading Phase Date."

¹⁶ 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).

¹⁷ 15 U.S.C. 78f(b).

¹⁸ 15 U.S.C. 78f(b)(5).

in securities; 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.

A. Access to ISE Stock Exchange

The class of members who will be eligible to trade on the ISE Stock Exchange are Equity EAMs. All current EAMs of the Exchange are eligible to become Equity EAMs. Any broker-dealer that is not currently an EAM can become an Equity EAM first by applying for EAM status through the existing membership process and then by connecting to the ISE Stock Exchange through the FIX or CMS protocols and paying any applicable fees. Such fees will be the same for current and new EAMs seeking to become Equity EAMs. The Commission believes that the proposed definition of, and the procedures relating to authorization of an EAM to act as, an Equity EAM are consistent with the Act.

B. Order Types

The following order types will be eligible for execution on the ISE Stock Exchange, including MidPoint Match orders, which are described below.

Market Orders: A Market Order is an order to buy or sell a stated amount of a security that is to be executed immediately and automatically at the best available price(s)¹⁹ when the order reaches the ISE Stock Exchange, to the greatest extent possible without causing an execution during regular trading hours at a price that is inferior to a Protected Quotation ("Trade-Through"). Any unexecuted shares of a Market Order may be routed in whole or in part to other Trading Centers²⁰ with Protected Quotations.

Limit Orders: A Limit Order is a one-sided order to buy or sell a stated quantity of a security at a specified price or better. The types of Limit Orders that the ISE Stock Exchange will accept include Reserve Orders, Immediate-or-Cancel ("IOC") Orders, Intermarket Sweep Orders ("ISOs"), Fill-or-Kill ("FOK") Orders, Not Routable Orders, and Post Only Orders.

Reserve Orders will have a portion of their size displayed, while a reserve

portion of their size at the same price will not be displayed. The reserve size will be used to refresh the displayed size when the displayed size is executed in full. When the displayed size of a Reserve Order is replenished from the reserve size, the displayed order is considered newly entered for purposes of time priority.

IOC Orders will be executed immediately and automatically against existing orders on the System at the best available price(s) to the greatest extent possible without causing a Trade-Through, and any unexecuted balance will be cancelled. Any Equity EAM may use an IOC Order to immediately and automatically execute against the full size of the displayed quotation on the System (including any undisplayed or reserve size available at the price of the displayed quotation).

With respect to orders received by the ISE Stock Exchange, ISOs are orders to be executed in whole or in part upon receipt against existing orders on the System at their executable price, in order of their ranking and without regard to better-priced quotations displayed at other Trading Centers, and if not so executed are to be cancelled. With respect to orders sent by the ISE Stock Exchange to other Trading Centers, ISOs are orders to be executed in whole or in part at such Trading Centers without regard to better-priced quotations displayed at other Trading Centers, and if not so executed are to be cancelled.²¹

FOK Orders are to be executed in their entirety or cancelled upon receipt. Not Routable Orders are to be executed in whole or in part upon receipt, and if not fully executed, displayed on the ISE Stock Exchange, as long as the order would not be executable against a Protected Quotation. Post Only Orders are to be displayed on the ISE Stock Exchange upon receipt or cancelled if they are executable upon entry, either on the ISE Stock Exchange or at another Trading Center.

Pegged Orders: Pegged Orders are Limit Orders to buy or sell a stated amount of a security at a displayed price set to track the current NBBO. The tracking of the relevant NBBO for Pegged Orders will occur on a real-time basis. If the calculated price for the Pegged Order would exceed its limit price, it will no longer track the NBBO and will remain displayed at its limit price.

The Commission believes that these order types are appropriate in the

context of the trading services proposed to be offered by the ISE Stock Exchange. In addition, these order types should help provide market participants with flexibility in executing transactions that meet the specific requirements of the order type.

C. Operating Hours and Opening Process

The ISE Stock Exchange will operate during regular trading hours.²² The System will accept orders each day prior to the opening.²³ The ISE Stock Exchange will open based upon the opening of the primary market for a security.²⁴ When the primary market is either the NYSE or the Amex, the opening trade will be executed at the midpoint of the first reported NBBO subsequent to a reported trade on the primary market. When the primary market is Nasdaq, the opening trade will be executed at the midpoint of the first reported NBBO. All orders eligible to trade at the midpoint will be processed in time sequence, beginning with the oldest order. Matches will occur until there is no remaining volume or there is an imbalance of orders. Following the opening execution process in an individual security, all orders remaining will be executed in accordance with the proposed ISE rules, as more fully discussed in the following section. All unexecuted orders will be displayed on the order book, cancelled, or routed to other Trading Centers in accordance with the proposed rules.

The Commission believes that the proposed rules relating to the System's operating hours and opening procedures are consistent with the Act.

D. Order Execution and Priority

Once the opening occurs for individual securities, the ISE Stock Exchange will operate during regular trading hours. All orders will be ranked automatically by the ISE Stock Exchange following price-time priority as soon they are entered in the order book. Orders are ranked beginning with the highest priced orders to buy and the lowest priced orders to sell.²⁵ For the

²² For common stock, the hours of business for the ISE Stock Exchange will be 9:30 a.m. until 4 p.m. (ET). For securities other than common stock, the hours of business are set forth in proposed ISE Rules 2123 through 2127. See proposed ISE Rule 2102.

²³ All order types other than Stop, Stop Limit, No MPM, Post Only, FOK, and IOC may participate in the opening transaction.

²⁴ Proposed ISE Rule 2106(c) defines the primary market as the listing market for a security. If a security is traded on both the NYSE and the Amex, the primary market would be considered the NYSE. If a security is listed on both the NYSE and Nasdaq, the NYSE would be considered the primary market.

²⁵ See proposed ISE Rule 2107.

¹⁹ The "best available price" means the highest bid price and the lowest offer price, including orders with executable undisplayed interest to buy or sell and interest to buy or sell that may exist in MidPoint Match. See proposed ISE Rule 2100(c)(3).

²⁰ A "Trading Center" is a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent. See proposed ISE Rule 2100(c)(20).

²¹ The Exchange intends the ISO order type to be equivalent to the "intermarket sweep order" defined in Rule 600(b)(30) of Regulation NMS under the Act, 17 CFR 242.600(b)(30).

purposes of ranking, the System will use the price at which the order is displayed. Within each price, orders will be ranked in time priority based on the time that an order is displayed or "updated" at that price, except that the undisplayed portions of Reserve Orders will be ranked after all other orders and displayed portions of Reserve Orders at the same price. When the displayed size of a Reserve Order is replenished from the reserve size, the displayed order is considered newly entered for the purposes of time priority.

In addition, all orders will be available for price improvement at the midpoint of the NBBO if contra-side interest exists in MidPoint Match, unless the order is marked "No MPM."²⁶ Except as indicated below, incoming orders will be executed at or within the NBBO. The Commission believes that the proposed rules relating to order priority and order execution are consistent with the Act.²⁷

E. Compliance With Regulation NMS Under the Act

The System is designed to automatically prevent Trade-Throughs of Protected Quotations. The System will accomplish this in two principal ways: (i) By providing outbound routing for those orders that will be available to route; and (ii) by displaying orders at prices that would not cause a Trade-Through when executed. Additionally, the System will take advantage of various exceptions to Rule 611 of

²⁶ Equity EAMs can choose to place orders into MidPoint Match or into the displayed market. Orders placed into the displayed market will be eligible, by default, to interact with MidPoint Match orders for purposes of gaining price improvement. Optionally, orders in the displayed market can bypass MidPoint Match by being marked as No MPM.

²⁷ Section 11(a) of the Act, 15 U.S.C. 78k(a)(1), prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or an associated person exercises discretion, unless an exception applies. Rule 11a2-2(T) under the Act, 17 CFR 240.11a2-2(T), commonly known as the "effect versus execute" rule, provides exchange members with an exemption from this prohibition. The Exchange represents that, consistent with this rule, the System's time-priority execution parameters will place all participants on the "same footing," and no participant will enjoy any special control over the timing of execution or any special order handling advantages. According to the Exchange, all orders will be transmitted directly to the System by electronic means, and, once submitted, all orders will be executed, displayed, cancelled, or routed automatically by the System, based on established trading rules. The Commission notes that the Exchange would enforce this requirement pursuant to its obligation under Section 6(b)(1) of the Act, 15 U.S.C. 78f(b)(1), to enforce compliance by its members and persons associated with its members with the Federal securities laws and rules thereunder.

Regulation NMS under the Act.²⁸ The Exchange has proposed to adopt an exception ("self-help") to allow for the System to Trade-Through a Protected Quotation displayed by a Trading Center that is experiencing a failure, material delay, or malfunction of its systems or equipment. If another Trading Center repeatedly fails to respond within one second to incoming orders attempting to access its Protected Quotations, the System may bypass those Protected Quotations by: (i) Notifying the non-responding Trading Center immediately after (or at the same time as) electing self-help; and (ii) assessing whether the cause of the problem lies with its own systems and, if so, taking immediate steps to resolve the problem. ISOs may, by definition, trade at a price inferior to a Protected Quotation. In addition, transactions may be executed at a time when the Protected Quotations are crossed.

The ISE Stock Exchange will not intentionally lock or cross any Protected Quotations on another Trading Center,²⁹ except in certain circumstances. For instance, the System may lock or cross a Protected Quotation: (i) When a Protected Bid is higher than a Protected Offer;³⁰ or (ii) if the locking or crossing quotation is an automated quotation and an ISO has simultaneously been routed to execute against the full displayed size of the locked or crossed Protected Quotation.

The Commission believes that the proposed rule change is consistent with the requirements of Rule 610(d) and Rule 611 of Regulation NMS.

F. Order Routing

The ISE Stock Exchange will offer a routing service for Equity EAMs, when it does not have interest equal to or better than the Protected Bid or Protected Offer.³¹ Certain order types, including Market Orders and Limit Orders, are eligible to be routed.³² To be eligible to enter routable orders into the ISE Stock Exchange, Equity EAMs must, among other things, enter into a Routing Agreement with the outbound routing facility of the Exchange.³³

²⁸ See proposed ISE Rule 2107(c).

²⁹ See proposed ISE Rule 2112.

³⁰ See proposed ISE Rule 2100(c)(15).

³¹ Prior to February 5, 2007, the Regulation NMS "Trading Phase Date," the ISE Stock Exchange will not execute orders at a price that is inferior to the best bid or offer of other Trading Centers.

³² See proposed ISE Rule 2107(d).

³³ See proposed ISE Rule 2105(d). A "Routing Agreement" is an agreement between an Equity EAM and the outbound routing facility of the ISE Stock Exchange, under which the outbound routing facility agrees to act as agent for routing orders of the Equity EAM entered into the ISE Stock Exchange to other market centers or broker-dealers

The System will accept the following orders to be handled on the ISE Stock Exchange, without routing to another Trading Center: IOC Orders, FOK Orders, Not Routable Orders, and Post Only Orders.³⁴ No Equity EAM may enter any other type of order unless it has entered into a Routing Agreement with the outbound routing facility of the Exchange.³⁵

Market Orders and Routable Limit Orders Executable on the ISE Stock Exchange. For orders that are routable, an IOC or ISO will automatically be sent to one or more Trading Centers with a Protected Quotation that is better than the ISE Stock Exchange quote for the lesser of the full displayed size of the Protected Quotation or the balance of the order. Any additional balance of the order will be executed on the ISE Stock Exchange simultaneously. If the market is crossed, the order will be handled as described below.

Routable Limit Orders Unexecutable on the ISE Stock Exchange. If display of a Limit Order (or any balance thereof) on the ISE Stock Exchange would lock or cross a Protected Quotation, an ISO will automatically be sent to one or more Trading Centers with a Protected Quotation that would be locked or crossed by the display of the order for up to the full displayed size of the Protected Quotation. Any additional balance of the order will be displayed on the ISE Stock Exchange immediately.

Market Orders Unexecutable on the ISE Stock Exchange. An IOC will automatically be sent to one or more Trading Centers with a Protected Quotation for the full size of the Market Order that is not executable on the ISE Stock Exchange.

The Commission finds that the proposed rules governing the routing of orders to other Trading Centers are consistent with the Act.

G. Outbound Routing Facility

In connection with the proposed trading rules described above, the Exchange intends to enter into a contractual relationship with a broker-dealer that will function solely as the outbound routing facility ("ORF") of the Exchange. The ORF will be a member of both the National Association of Securities Dealers, Inc. ("NASD") and

for execution, other than orders excluded by the terms of the Routing Agreement, whenever such routing is required. See proposed ISE Rule 2100(c)(18).

³⁴ See proposed ISE Rules 2107(b)(2)(i), (ii), (iii), and (iv), respectively. In addition, MidPoint Match orders would not be routed, because MidPoint Match will execute all trades at the midpoint of the NBBO.

³⁵ See proposed ISE Rule 2105(d)

ISE. The ORF will provide an optional routing service for the Exchange, in which the ORF will route orders from the ISE Stock Exchange to Trading Centers with Protected Quotations through other brokers ("Access Brokers") that are members or participants of those Trading Centers. As an outbound router, the ORF will receive routing instructions from the System, route orders to another Trading Center through an Access Broker, and be responsible for reporting resulting executions back to the System, which in turn will report resulting executions back to the Equity EAM. All orders routed through the ORF will be subject to the Exchange's rules. The ORF would not be able to change the terms of an order or the routing instructions, nor would it have any discretion about where to route an order. The ORF includes the clearing functions that the ORF may perform for trades with respect to orders routed to other Trading Centers. Use of the ORF is optional for Equity EAMs.

The outbound router function of the ORF will operate as a facility (as defined in Section 3(a)(2) of the Act) of the Exchange.³⁶ As such, the outbound router function of the ORF is subject to the Commission's continuing oversight. In particular, and without limitation, under the Act, the Exchange is responsible for filing with the Commission proposed rule changes and fees relating to the ORF outbound router function, and the ORF is subject to exchange non-discrimination requirements.³⁷

Pursuant to Rule 17d-1 under the Act,³⁸ where a member of the Securities Investor Protection Corporation is a member of more than one self-regulatory organization ("SRO"), the Commission will designate to one of such organizations the responsibility for examining such member for compliance with the applicable financial responsibility rules.³⁹ The SRO designation by the Commission is referred to as a "Designated Examining Authority" ("DEA"). As noted above, the ORF will apply to become a member organization of the Exchange and a

member of the NASD. The NASD is an SRO not affiliated with the Exchange or its affiliates and is a DEA pursuant to Rule 17d-1 under the Act.⁴⁰ Furthermore, the Exchange represents that it will enter into a 17d-2 Agreement with the NASD to delegate to the NASD all regulatory oversight and enforcement responsibilities with respect to the ORF pursuant to applicable laws. The Exchange represents that it will submit the 17d-2 Agreement to the Commission under Rule 17d-2 within 90 days of the date of this order.

The Exchange will establish and maintain procedures and internal controls to restrict the flow of confidential and proprietary information between the Exchange and the ORF and any other entity or affiliate of the ORF.⁴¹ The books, records, premises, officers, directors, agents, and employees of the ORF, as a facility of the Exchange, shall be deemed to be the books, records, premises, officers, directors, agents, and employees of the Exchange for purposes of and subject to oversight pursuant to the Act. The books and records of the ORF, as a facility of the Exchange, shall be subject at all times to inspection and copying by the Exchange and the Commission.

The Commission agrees with the Exchange that the ORF's services would qualify it as a "facility" of the Exchange, and, consequently, the operation of the ORF will be subject to Exchange oversight, as well as Commission oversight. The Commission notes that the outbound routing functionality is not the exclusive means for accessing better-priced orders in other market centers should an order not be executable on the ISE Stock Exchange. Accordingly, the ORF's routing services are optional, and an Equity EAM is free to route its orders to other market centers through alternative means. In light of the protections afforded by the conditions discussed above, the Commission believes that the Exchange's outbound routing function, and the rules and procedures governing the ORF, are appropriate and consistent with the Act.

H. MidPoint Match

MidPoint Match is a mechanism of the ISE Stock Exchange for trading common stocks and similar securities in a continuous midpoint matching system.⁴² Equity EAMs will be able to enter MidPoint Match orders to buy or sell at the midpoint of the NBBO.

Although orders in MidPoint Match will be unpriced, members may specify a boundary price above which they will not buy (or below which they will not sell). The System will continuously monitor buy and sell orders in MidPoint Match and will execute orders at the midpoint of the NBBO as long as the execution does not violate the boundary price on an order.

When entering an order, a member can specify what, if any, information the System should disseminate:

(i) The member can specify that the System not disseminate any information regarding the order ("Standard Order"); or

(ii) The member can specify that the System disseminate that there is a pending order in a particular security, but not identify the side or the size of the order ("Solicitation of Interest" or "SOI").⁴³

MidPoint Match will reject an SOI (but not a Standard Order) with a boundary price that is not then currently executable. Upon arrival of an SOI, MidPoint Match will immediately generate a single broadcast internally to all Equity EAMs that have programmed their systems to accept this message announcing the arrival of the order. An Equity EAM entering an SOI may not cancel that SOI for five seconds. In addition, if an SOI is not executed within ten seconds, the SOI will convert into a Standard Order.

Because MidPoint Match will execute all trades at the midpoint of the NBBO, MidPoint Match will never execute a trade outside of the NBBO. In addition, MidPoint Match will not execute a trade if the quotation for a security is "crossed," with the national best bid being greater than the national best offer. In that situation, MidPoint Match will suspend executions, since both buyers and sellers may be able to receive executions in other markets at prices better than the NBBO midpoint. If the quotation is "locked," with the national best bid equaling the national best offer, MidPoint Match will execute all trades at the locked price.

Unless marked otherwise, all incoming orders to the ISE Stock Exchange will be eligible for price improvement at the midpoint of the NBBO if contra-side interest exists in MidPoint Match. As set forth in the proposed rules, incoming orders will be executed at the best available price on the ISE Stock Exchange, which means the highest bid price and the lowest offer price, including undisplaced

³⁶ 15 U.S.C. 78c(a)(2).

³⁷ 15 U.S.C. 78f(b)(5).

³⁸ 17 CFR 240.17d-1.

³⁹ Pursuant to Rule 17d-1 under the Act, in making such designation the Commission will take into consideration the regulatory capabilities and procedures of the SROs, availability of staff, convenience of location, unnecessary regulatory duplication, and such other factors as the Commission may consider germane to the protection of investors, the cooperation and coordination among SROs, and the development of a national market system for the clearance and settlement of securities transactions.

⁴⁰ 17 CFR 240.17d-1.

⁴¹ See proposed ISE Rule 2108.

⁴² See proposed ISE Rule 2129.

⁴³ However, an SOI must be for a minimum of 2000 shares, so users would be aware that the SOI represented interest of at least that size.

orders to buy or sell that may exist in MidPoint Match. Orders marked "No MPM" will not be executed against orders residing in MidPoint Match.

The Commission believes that the order types and execution parameters established in MidPoint Match are consistent with the Act.

I. Anonymity

Except as described below, transactions executed on the ISE Stock Exchange will be processed anonymously.⁴⁴ This means that the ISE Stock Exchange transaction reports will indicate the details of the transaction but will not reveal contra-party identities.⁴⁵ The Commission notes that post-trade anonymity should not compromise an Equity EAM's ability to settle an erroneous trade, because under proposed ISE Rule 2128, the clearly erroneous execution resolution process is coordinated by the Exchange, without the need for contra parties to know each other's identities.

The Exchange will only reveal the identity of the Equity EAM or the Equity EAM's clearing firm in the following circumstances: (i) For regulatory purposes or to comply with an order of a court or arbitrator; (ii) when the National Securities Clearing Corporation ("NSCC") ceases to act for the Equity EAM or the Equity EAM's clearing firm, and NSCC determines not to guarantee the settlement of the Equity EAM's trades; or (iii) on risk management reports provided to the contra-party of the Equity EAM or Equity EAM's

clearing firm each day after 4:00 p.m. that discloses trading activity on an aggregate dollar value basis. Also, the Exchange will reveal to an Equity EAM, no later than the end of the day on the date an anonymous trade was executed, when that Equity EAM submits an order that has executed against an order submitted by that same Equity EAM.

The Commission finds that the Exchange's proposed anonymity provisions are appropriate and consistent with the Act.

J. Clearly Erroneous Executions

Pursuant to proposed ISE Rule 2128, an Equity EAM that receives an execution on an order that was submitted erroneously to the ISE Stock Exchange for its own or a customer account may request that Market Control, along with a member of the regulatory staff, review the transaction under proposed ISE Rule 2128(b) within the time limits described therein. Market Control will review the transaction with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. A member of the regulatory staff will advise and participate in all steps of Market Control's review of the transaction. Based upon this review, Market Control will decline to "break" a disputed transaction if Market Control believes that the transaction under dispute is not clearly erroneous. However, if Market Control determines that the transaction in dispute is clearly erroneous, Market Control will declare that the transaction is null and void or modify one or more terms of the transaction. When adjusting the terms of a transaction, Market Control will seek to adjust the price and/or size of the transaction to achieve an equitable rectification of the error that would place the parties to a transaction in the same position, or as close as possible to the same position, as they would have been in had the error not occurred. For purposes of the clearly erroneous rule, the terms of a transaction are "clearly erroneous" when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.

Market Control may, on its own motion, review transactions on the ISE Stock Exchange that arose during any disruption or malfunction in the use or operation of any electronic communications or trading facilities of the ISE Stock Exchange, or extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the

maintenance of a fair and orderly market or the protection of investors and the public interest. Each affected Equity EAM will be notified as soon as practicable, and the Equity EAM aggrieved by the action may appeal such action to the Trade Panel.

The Commission believes that proposed ISE Rule 2128 is consistent with the Act because it is reasonably designed to promote fair and orderly markets by setting forth procedures for reviewing and, if necessary, nullifying or adjusting a clearly erroneous trade. The Commission previously has determined that it is consistent with the Act for an exchange to be able to nullify or adjust trades that are clearly erroneous.⁴⁶

K. Miscellaneous Rules

Proposed ISE Rules 2123 (Investment Company Unit), 2124 (Trust Issued Receipts), 2125 (Commodity-Based Trust Shares), 2126 (Currency Trust Shares), and 2127 (Partnership Units) would permit the trading of derivative products on the ISE Stock Exchange. While these proposed ISE rules would allow the ISE Stock Exchange to trade such products by either listing and/or trading pursuant to UTP, the ISE Stock Exchange will only trade these products pursuant to UTP. In order to list such products, the Exchange would first need to seek Commission approval and amend its applicable rules.

Proposed ISE Rule 2117 (Settlement Through Clearing Corporations) adds provisions governing the settlement and clearing of equity securities.

Proposed ISE Rule 2101 (Equity Securities Traded) provides that, if the Exchange trades its own securities, or the securities of an affiliate or any entity that operates and/or owns a trading system or facility of the Exchange, on the ISE Stock Exchange, the Exchange will file a report each quarter with the SEC describing: (i) The Exchange's monitoring of the issuer's compliance with the Exchange's listing standards (in the event the Exchange adopts such listing standards); and (ii) the Exchange's monitoring of the trading of the security. If the Exchange adopts listing standards, an independent accounting firm must annually review the listing standards for the subject security to ensure that the issuer is in compliance with the applicable listing requirements. If the Exchange determines that the subject issuer is non-compliant with any listing standard, the Exchange must file a

⁴⁴ See proposed ISE Rule 2117.

⁴⁵ ISE intends to submit a request for a limited exemption from paragraph (a)(2)(i)(A) of Rule 10b-10 under the Act, 17 CFR 240.10b-10, on behalf of Equity EAMs that execute trades on the ISE Stock Exchange for their customers and a request for no-action relief with respect to the corresponding books and records requirements of Rules 17a-3 and 17a-4 under the Act, 17 CFR 240.17a-3 and 17a-4, respectively. Rule 10b-10, among other things, requires a broker-dealer to disclose to its customers the identity of the party the broker-dealer sold to, or bought from, to fill the customer's order. The ISE Stock Exchange will not routinely reveal the identity of the actual contra-party when the order is executed against another Equity EAM. Therefore, the Equity EAMs will not be able to comply with the contra-party identification requirement of Rule 10b-10. To permit Equity EAMs to utilize the ISE Stock Exchange without violating Rule 10b-10, the Exchange is seeking an exemption, on behalf of such Equity EAMs, from the contra-party identification requirement. Additionally, the Exchange has asked the Commission not to recommend enforcement action for violations of the corresponding books and records requirements of Rules 17a-3 and 17a-4 if, in lieu of making and preserving a separate record, a broker-dealer relies on the Exchange's retention of the identities of Equity EAMs that execute anonymous trades on the ISE Stock Exchange. The Exchange represents that it will not commence operation of the displayed market unless the Exchange receives an exemption from Rule 10b-10 with respect to that market.

⁴⁶ See, e.g., NYSE Arca Equities Rule 7.10 (Clearly Erroneous Executions) and Nasdaq Rule 11890 (Clearly Erroneous Transactions).

report with the Commission at the same time that the Exchange notifies the issuer of its non-compliance.

The following Rules have been incorporated from the Exchange's options rules: ISE Rule 100 (Definitions) is being expanded to include equities in the following definitions: Bid, clearing corporation, offer and order; ISE Rule 500 (Designation of Securities) is being amended to accommodate for the newly adopted rules in Chapter 21; and ISE Rules 702 and 703 (Trading Halts and Trading Halts Due to Extraordinary Market Volatility, respectively) are being amended to account for halting trading in equity securities.⁴⁷

The Commission finds that these various proposed ISE rules are consistent with the Act.

L. Accelerated Approval of Amendment No. 1

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after publishing notice of Amendment No. 1 in the **Federal Register** pursuant to Section 19(b)(2) of the Act.⁴⁸

In Amendment No. 1, the Exchange amended proposed ISE Rule 2110 (Minimum Price Variation) to conform with the language of Rule 612 of Regulation NMS and amended proposed ISE Rule 2118 (Trade Modifiers) to incorporate applicable requirements of Rule 611 of Regulation NMS. The Exchange also amended proposed Rule 2106 (Opening Process) to reflect that Stop Orders, Stop Limit Orders, No MPM Orders, Post Only Orders, FOK Orders and IOC Orders cannot participate in the opening process and to add a provision that the System would cease matching orders in a security upon the close of the primary market for that security. In addition, the Exchange changed the term "partial round lot" to "mixed lots" to correspond to the current industry term and clarified corresponding proposed ISE Rule 2105 (Order Entry). The Exchange also added proposed ISE Rule 2120 (Taking or Supplying Securities), which governs situations in which an Equity EAM can, upon receipt of a customer order, take or supply securities named in the order on behalf of itself or related parties.

In Amendment No. 1, the Exchange made certain revisions to the proposed rules to provide for the interaction of

MidPoint Match orders with other orders entered into the ISE Stock Exchange, as described more fully above. The Exchange also revised the text of proposed ISE Rule 2107(d) to clarify that, prior to February 5, 2007, the ISE Stock Exchange will not trade through the best bid or offer of other Trading Centers, while on and after February 5, 2007, the ISE Stock Exchange will not trade through a Protected Quotation. Finally, the Exchange made clarifying changes to the clearing requirements and other proposed rules and made changes to the proposed rules to conform them to the rules filed with the Commission on the Form PILOT relating to MidPoint Match.⁴⁹

The Commission notes that Amendment No. 1 is intended to clarify various provisions of the Exchange's proposed rules. The Commission believes that Amendment No. 1 proposes revisions that are non-substantive in nature and do not raise novel issues, and that Amendment No. 1 is consistent with the Act. Therefore, the Commission finds good cause to accelerate approval of Amendment No. 1, pursuant to Section 19(b)(2) of the Act.⁵⁰

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1, including whether Amendment No. 1 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. Please include File No. SR-ISE-2006-48 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 20549-1090.

All submissions should refer to Amendment No. 1 to File No. SR-ISE-2006-48. 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 Exchange. 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 Amendment No. 1 to File No. SR-ISE-2006-48 and should be submitted on or before October 25, 2006.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁵¹ that the proposed rule change (SR-ISE-2006-48) be, and it hereby is, approved, and Amendment No. 1 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵²

Nancy M. Morris,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-54514; File No. SR-OCC-2006-05]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Expiration Date Exercise Procedures

September 26, 2006.

I. Introduction

On April 6, 2006, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-OCC-2006-05 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ Notice

⁴⁷ In addition, the Exchange proposes to apply certain of its options rules to the trading of equity securities on the ISE Stock Exchange, as set forth in Appendix A to proposed Chapter 21 of the ISE rules.

⁴⁸ 15 U.S.C. 78s(b)(2).

⁴⁹ See *supra* note 15.

⁵⁰ 15 U.S.C. 78s(b)(2).

⁵¹ 15 U.S.C. 78s(b)(2).

⁵² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).