

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58861; File No. SR-ISE-2008-78)

October 27, 2008

Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing of Proposed Rule Change Relating to Quoting Obligations for Competitive Market Makers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 21, 2008, the International Securities Exchange, LLC (the "Exchange" or the "ISE") filed with the Securities and Exchange Commission the proposed rule change, as described in Items I, II, and III below, which items have been prepared by the self-regulatory organization. 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 ISE Rules 713, 804 and 805 to establish a new quoting obligation for the Exchange's Competitive Market Makers ("CMMs"). The text of the proposed rule change is as follows, with deletions in [brackets] and additions underlined:

Rule 713. Priority of Quotes and Orders

(a) through (f) no change.

Supplementary Material To Rule 713

.01 and .02 no change.

.03 Preferred Orders. An Electronic Access Member may designate a "Preferred Market Maker" on orders it enters into the System ("Preferred Orders").

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

(a) A Preferred Market Maker may be the Primary Market Maker appointed to the options class or any Competitive Market Maker appointed to the options class.

(b) If the Preferred Market Maker is not quoting at a price equal to the NBBO at the time the Preferred Order is received, the allocation procedure contained in paragraph .01 shall be applied to the execution of the Preferred Order.

(c) If the Preferred Market Maker is quoting at the NBBO at the time the Preferred Order is received, the allocation procedure contained in paragraph .01 shall be applied to the execution of the Preferred Order except that the Primary Market Maker will not receive the participation rights described in paragraphs .01(b) and (c), and instead the Preferred Market Maker shall have participation rights equal to the greater of:

- (i) the proportion of the total size at the best price represented by the size of its quote, or
- (ii) sixty percent (60%) of the contracts to be allocated if there is only one (1) other Non-Customer Order or market maker quotation at the best price and forty percent (40%) if there are two (2) or more other Non-Customer Orders and/or market maker quotes at the best price.

(d) Preferred Competitive Market Makers are subject to enhanced quoting requirements as provided in Rule 804(e)(2)(ii).

.04 No change.

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Rule 804. Market Maker Quotations

(a) through (d) no change.

(e) *Continuous Quotes.* A market maker must enter continuous quotations for the options classes to which it is appointed pursuant to the following:

(1) Primary Market Makers. Primary Market Makers must enter continuous quotations and enter into any resulting transactions in all of the series listed on the Exchange of the options classes to which he is appointed on a daily basis.

(2) Competitive Market Makers. (i) On any given day, a Competitive Market Maker must participate in the opening rotation and make markets and enter into any resulting transactions on a continuous basis in [all] at least 60% of the series listed on the Exchange of at least sixty percent (60%) of the options classes for the Group to which the Competitive Market Maker is appointed or [60] 40 options classes in the Group, whichever is lesser.

(ii) Whenever a Competitive Market Maker enters a quote in an options class to which it is appointed, it must maintain continuous quotations for [all] that series and at least 60% of the series of the options class listed on the Exchange until the close of trading that day[.]; provided, however, that a Competitive Market Maker shall be required to maintain continuous quotations for that series and at least 90% of the series of any options class in which it receives Preferred Orders (see Supplementary Material .03 to Rule 713 regarding Preferred Orders).

(iii) A Competitive Market Maker may be called upon by an Exchange official designated by the Board to submit a single quote or maintain continuous quotes in one or more of the series of an options class to which the Competitive Market Maker is appointed whenever, in the judgment of such official, it is necessary to do so in the interest of fair and orderly markets.

(f) and (g) no change.

Supplementary Material To Rule 804

[.01 Notwithstanding ISE Rules 804(e)(2)(i) - (ii), for a pilot period that commences on September 20, 2007 and expires on September 19, 2008, and limited to options classes

overlying no more than twenty (20) individual stocks as specifically designated by the Exchange (“Pilot Program Securities”), a Competitive Market Maker must participate in the opening rotation and make markets and enter into any resulting transactions on a continuous basis in only sixty percent (60%) of the series of the options classes overlying the Pilot Program Securities. Whenever a Competitive Market Maker enters a quote in a series of the options classes of the Pilot Program Securities, it must maintain continuous quotations in that series until the close of trading that day.]

Rule 805. Market Maker Orders

(a) no change.

(b) Options Classes Other Than Those to Which Appointed.

(1) A market maker may enter all order types permitted to be entered by non-customer participants under the Rules to buy or sell options in classes of options listed on the Exchange to which the market maker is not appointed under Rule 802, provided that:

(i) the spread between a limit order to buy and a limit order to sell the same options contract complies with the parameters contained in Rule 803(b)(4); and

(ii) the market maker does not enter orders in options classes to which it is otherwise appointed, either as a Competitive or Primary Market Maker.

(2) Competitive Market Makers. The total number of contracts executed during a quarter by a Competitive Market Maker in options classes to which it is not appointed may not exceed twenty-five percent (25%) of the total number of contracts

traded [per each] by such Competitive Market Maker [Membership] in classes to which it is appointed and with respect to which it was quoting pursuant to Rule 804(e)(2).

(3) no change.

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

In its filing with the Commission, the self-regulatory organization 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 self-regulatory organization 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 Exchange proposes to amend ISE Rules 713, 804 and 805 to establish a new quoting obligation for the Exchange's CMMs. ISE currently requires CMMs to participate in the opening and maintain continuous quotations in all of the series of at least 60 per cent of the options classes in the bin or 60 classes, whichever is lesser. Additionally, if a CMM chooses to quote any series of an options class above and beyond this minimum requirement, it must then maintain continuous quotations in all of the series of the class throughout that trading day. Last September, the Exchange initiated a pilot to relax the continuous quoting obligations for CMMs in 20 options classes.³ Under the Pilot, CMMs were required to maintain continuous quotations

³ See Securities Exchange Act Release No. 56444 (September 14, 2007), 72 FR 54089 (September 21, 2007) (Order Granting Approval of SR-ISE-2007-45 Relating to a Quote Mitigation Plan for Competitive Market Makers) (the "Pilot").

in only 60 per cent of the series of an options class overlying the pilot program securities. The Pilot recently expired and the Exchange now proposes to establish relaxed quoting requirements for CMMs on a permanent basis.

With the explosion of quotation traffic – exacerbated by the penny pilot – we continue to seek ways to mitigate the generation of quotations. Our experience with the Pilot indicates that relaxing the continuous quoting obligation has had no negative effect on the quality of our markets. In practice, market makers simply widen their quotations when they do not want to trade in a particular series, so requiring them to maintain continuous quotations in all series merely increases capacity requirements for the market makers. Therefore, ISE proposes to adopt the 60 per cent standard for all options series on a permanent basis, with one exception related to CMMs that receive preferenced order flow. In this circumstance, a CMM receives the benefit of enhanced allocation rights similar to, and instead of, a Primary Market Maker. Therefore, it is appropriate to apply a higher continuous quotation standard on such CMMs, which we propose to be 90 per cent of the series.⁴

Additionally, ISE proposes to lower the minimum number of options classes that a CMM is required to quote from 60 to 40. While as stated above there is little benefit to the quality of our markets when CMMs are forced to maintain continuous quotations in options classes in which they do not want to trade, this requirement discourages some potential market participants because it requires too much systems capacity relative to the number of classes they are actually interested in trading on the ISE. Thus, the Exchange believes lowering the requirement would attract additional market making participants on the ISE.

⁴ See CBOE Rule 8.13. The Chicago Board Options Exchange has a similar quotation standard for its preferred market makers.

Finally, the Exchange proposes to amend Rule 805 (Market Maker Orders) to restrict the percentage of volume a CMM may execute in options to which it is not appointed. Specifically, the rule currently provides that a CMM may execute up to 25% of its volume in options classes to which it is not appointed. Since the Exchange is lowering the number of appointed class in which a CMM is required to quote, the Exchange believes it is appropriate to base the 25% allowance on volume that is executed while a CMM is actually fulfilling its market maker quotation obligations.

Overall, the Exchange believes the proposed rule change is a step towards adopting an internal quote mitigation plan that is beneficial both to the Exchange and to its members without adversely affecting ISE's quality of markets.

2. Statutory Basis

The basis under the Securities Exchange Act of 1934 (the "Act") for this proposed rule change is the requirement under Section 6(b)(5) 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, by relaxing the quoting requirements thereby reducing the number of options quotations required to be submitted, which should enable the Exchange to mitigate quote traffic and use of capacity without adversely affecting the Exchange's quality of markets.

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.

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. 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-2008-78 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-ISE-2008-78. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the principal office of the self-regulatory organization. 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-2008-78 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁵

Florence E. Harmon
Acting Secretary

⁵ 17 CFR 200.30-3(a)(12).