

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51447; File No. SR-ISE-2004-28)

March 30, 2005

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendments No. 1 and 2 Relating to Trading Options on Full and Reduced Values of the ISE 250 Index, the ISE 100 Index and the ISE 50 Index, Including Long-Term Options

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 September 10, 2004, the International Securities Exchange, Inc. (“Exchange” or “ISE”) 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 ISE. The ISE submitted Amendments No. 1 and No. 2 to the proposal on January 5, 2005,³ and on March 7, 2005, respectively.⁴ 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 to trade options on full and reduced values of three broad-based indexes, the ISE 250 Index, the ISE 100 Index and the ISE 50 Index. Options on these indexes would be cash-settled and would have European-style exercise provisions. The text of the proposed rule change is available on the ISE’s Web site (<http://www.iseoptions.com>),

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 set forth a list of the underlying components of the ISE Indexes.

⁴ Amendment No. 2 replaced the original filing in its entirety, proposed a reduced number of contracts for position and exercise limits, addressed one of the events that the Exchange will monitor on an annual basis, and made other technical corrections to the filing.

at the ISE's Office of the Secretary, and at the Commission. The text of the proposed rule change appears below. Additions are italicized; deletions are bracketed.

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Rule 2001. Definitions

Supplementary Material to Rule 2001

.01 The reporting authorities designated by the Exchange in respect of each index underlying an index options contract traded on the Exchange are as provided in the chart below.

<u>Underlying Index</u>	<u>Reporting Authority</u>
S&P SmallCap 600 Index	Standard & Poor's
Morgan Stanley Technology Index	American Stock Exchange
S&P MidCap 400 Index	Standard & Poor's
S&P 1000 Index	Standard & Poor's
Nasdaq 100 Index	The Nasdaq Stock Market
<u>ISE 250 Index</u>	<u>International Securities Exchange and Standard & Poor's</u>
<u>ISE 100 Index</u>	<u>International Securities Exchange and Standard & Poor's</u>
<u>ISE 50 Index</u>	<u>International Securities Exchange and Standard & Poor's</u>

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Rule 2004. Position Limits for Broad-Based Index Options

(a) Rule 412 generally shall govern position limits for broad-based index options, as modified by this Rule 2004. There may be no position limit for certain Specified (as provided in Rule 2000) broad-based index options contracts. All other broad-based index options contracts shall be subject to a contract limitation fixed by the Exchange, which shall not be larger than the limits provided in the chart below.

Broad-Based Underlying Index	Standard Limit (on the same side of the market)	Restrictions
S&P SmallCap 600 Index	100,000 contracts	No more than 60,000 near-term
S&P MidCap 400 Index	45,000 contracts	No more than 25,000 near-term
Reduced Value S&P 1000 Index	50,000 contracts	No more than 30,000 near-term
Micro S&P 1000 Index	500,000 contracts	No more than 300,000 near-term
Nasdaq 100 Index	75,000 contracts	None
Mini Nasdaq 100 Index	750,000 contracts	None
<u>ISE 250 Index</u>	<u>50,000 contracts</u>	<u>No more than 30,000 near-term</u>
<u>Mini ISE 250 Index</u>	<u>500,000 contracts</u>	<u>No more than 300,000 near-term</u>
<u>ISE 100 Index</u>	<u>50,000 contracts</u>	<u>No more than 30,000 near-term</u>
<u>Mini ISE 100 Index</u>	<u>500,000 contracts</u>	<u>No more than 300,000 near-term</u>
<u>ISE 50 Index</u>	<u>50,000 contracts</u>	<u>No more than 30,000 near-term</u>
<u>Mini ISE 50 Index</u>	<u>500,000 contracts</u>	<u>No more than 300,000 near-term</u>

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Rule 2009. Terms of Index Options Contracts

(a) General.

(4) “European-Style Exercise.” The following European-style index options, some of which may be A.M.-settled as provided in paragraph (a)(5), are approved for trading on the Exchange:

- (i) S&P SmallCap 600 Index
- (ii) Morgan Stanley Technology Index

- (iii) S&P MidCap 400 Index
- (iv) Reduced Value S&P 1000 Index
- (v) Micro S&P 1000 Index
- (vi) Full-size Nasdaq 100 Index
- (vii) Mini Nasdaq 100 Index
- (viii) ISE 250 Index
- (ix) Mini ISE 250 Index
- (x) ISE 100 Index
- (xi) Mini ISE 100 Index
- (xii) ISE 50 Index
- (xiii) Mini ISE 50 Index

(5) A.M.-Settled Index Options. The last day of trading for A.M.-settled index options shall be the business day preceding the last day of trading in the underlying securities prior to expiration. The current index value at the expiration of an A.M.-settled index option shall be determined, for all purposes under these Rules and the Rules of the Clearing Corporation, on the last day of trading in the underlying securities prior to expiration, by reference to the reported level of such index as derived from first reported sale (opening) prices of the underlying securities on such day, except that:

- (i) In the event that the primary market for an underlying security does not open for trading on that day, the price of that security shall be determined, for the purposes of calculating the current index value at expiration, as set forth in Rule 2008(g), unless the current index value at expiration is fixed in accordance with the Rules and By-Laws of the Clearing Corporation; and

(ii) In the event that the primary market for an underlying security is open for trading on that day, but that particular security does not open for trading on that day, the price of that security, for the purposes of calculating the current index value at expiration, shall be the last reported sale price of the security.

The following A.M.-settled index options are approved for trading on the Exchange:

- (i) S&P SmallCap 600 Index
- (ii) Morgan Stanley Technology Index
- (iii) S&P MidCap 400 Index
- (iv) Reduced Value S&P 1000 Index
- (v) Micro S&P 1000 Index
- (vi) Full-size Nasdaq 100 Index
- (vii) Mini Nasdaq 100 Index
- (viii) ISE 250 Index
- (ix) Mini ISE 250 Index
- (x) ISE 100 Index
- (xi) Mini ISE 100 Index
- (xii) ISE 50 Index
- (xiii) Mini ISE 50 Index

(c) Procedures for Adding and Deleting Strike Prices. The procedures for adding and deleting strike prices for index options are provided in Rule 504, as amended by the following:

(1) The interval between strike prices will be no less than \$5.00; provided, that in the case of the following classes of index options, the interval between strike prices will be no less than \$2.50:

- (i) S&P SmallCap 600, if the strike price is less than \$200.00
- (ii) Morgan Stanley Technology Index, if the strike price is less than \$200.00
- (iii) S&P MidCap 400 Index, if the strike price is less than \$200.00
- (iv) Reduced Value S&P 1000 Index, if the strike price is less than \$200.00
- (v) Micro S&P 1000 Index, if the strike price is less than \$200.00
- (vi) Full-size Nasdaq 100 Index, if the strike price is less than \$200.00
- (vii) Mini Nasdaq 100 Index, if the strike price is less than \$200.00
- (viii) ISE 250 Index, if the strike price is less than \$200.00
- (ix) Mini ISE 250 Index, if the strike price is less than \$200.00
- (x) ISE 100 Index, if the strike price is less than \$200.00
- (xi) Mini ISE 100 Index, if the strike price is less than \$200.00
- (xii) ISE 50 Index, if the strike price is less than \$200.00
- (xiii) Mini ISE 50 Index, if the strike price is less than \$200.00

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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 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, as amended. 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 Exchange proposes to amend its rules to provide for the listing and trading on the Exchange of cash-settled, European-style, index options on full and reduced values of the ISE 250 Index, the ISE 100 Index and the ISE 50 Index (collectively, the “ISE Indexes”).⁵ Specifically, the Exchange proposes to list options based upon the full value of the ISE Indexes (“Full-size ISE Indexes”) as well as one-tenth of the value of the ISE Indexes (“Mini ISE Indexes”).

Index Design and Composition

The ISE Indexes are designed to track the performance of the most highly capitalized publicly traded companies in the United States. Each index is a float-adjusted capitalization-weighted index,⁶ whose components are all headquartered in the United States and listed on either the New York Stock Exchange, Inc. (“NYSE”), the National Association of Securities Dealers, Inc. (“NASD”), Automated Quotation System (“NASDAQ”), or the American Stock Exchange LLC (“Amex”). All companies in the ISE Indexes will either be operating companies or Real Estate Investments Trusts. All other companies, such as Closed-end Funds, Exchange Traded Funds, Holding Companies, Investment Vehicles and Royalty Trusts are not eligible for inclusion.

⁵ A description of each of the ISE Indexes will be available on the Exchange’s publicly available web site at <http://www.iseoptions.com>.

⁶ The calculation of a float-adjusted, market-weighted index involves taking the summation of the product of the price of each stock in the index and the number of shares available to the public for trading, rather than the total shares outstanding for each issue. In contrast, a price-weighted index involves taking the summation of the prices of the stocks in the index.

Companies are selected for inclusion in the ISE Indexes by the Exchange based on the Exchange's methodology.⁷ Companies may not apply, and may not be nominated, for inclusion. Companies may be added or removed by the Exchange based on the methodology described below. In order for a company to be eligible for inclusion in the ISE Indexes, it must satisfy certain minimum criteria. One of the requirements for inclusion is that a company's ratio of cumulative shares traded to adjusted shares outstanding must be greater than 0.30 over the past 12 months. Another requirement that must be met by each company is the number of shares in its public float must constitute at least 50% of its total number of outstanding shares. To be eligible for inclusion in the ISE 100 Index, companies must meet one additional requirement: options on the component company's stock must be listed on the Exchange.

The ISE indexes are calculated and maintained by Standard & Poor's ("S&P") pursuant to the Exchange's rules-based methodology and instructions.

ISE 250 Index

The ISE 250 Index is designed to track the combined performance of the most highly capitalized stocks in the U.S. equity markets and specifically includes the top 250 stocks as ranked by market capitalization.

Components of the ISE 250 Index are selected using a rules-based methodology that is fully transparent. Its original selection pool includes all common stocks listed on the NYSE, Amex and NASDAQ. The entire index universe is ranked in descending order by unadjusted market capitalization. Companies that do not meet component eligibility requirements are removed. If a component has multiple share classes, the most liquid issue for that company is

⁷ Rules governing component selection of the ISE Indexes will be available on the Exchange's publicly available web site at <http://www.iseoptions.com>.

included. The top 250 companies, ranked by market capitalization, are then selected from the remaining universe.

Each component's eligibility and ranking is reviewed twice annually, in June and December of each calendar year. Any necessary component changes are made after the close on the third Friday of June and December, and become effective at the opening on the next trading day. Changes to the ISE 250 Index will be announced on ISE's publicly available website five trading days prior to the effective date.

In addition to the scheduled reviews, the ISE 250 Index is reviewed on an ongoing basis to accommodate extraordinary events and corporate actions, such as delistings, bankruptcies, mergers or acquisitions involving index components.

As set forth in Exhibit 3 to the proposal, as of June 11, 2004, following are the characteristics of the ISE 250 Index: (i) the total capitalization of all of the components in the Index is \$8.63 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component is \$328.14 billion (General Electric Co.), (b) the lowest capitalization of a component is \$5.47 billion (The Estee Lauder Co., Class A), (c) the mean capitalization of the components is \$34.51 billion, and (d) the median capitalization of the components is \$16.85 billion; (iii) regarding component price per share, (a) the highest price per share of a component is \$113.71 (Wellpoint Health Networks, Inc.), (b) the lowest price per share of a component is \$3.40 (Lucent Technologies, Inc.), (c) the mean price per share of the components is \$45.73, and (d) the median price per share of the components is \$42.67; (iv) regarding component weightings, (a) the highest weighting of a component is 3.8% (General Electric Co.), (b) the lowest weighting of a component is 0.1% (Estee Lauder Co., Class A), (c) the mean weighting of the components is 0.4%, (d) the median weighting of the components is 0.2%, and (e) the total

weighting of the top five highest weighted components is 15.9% (General Electric Co., Exxon Mobil Corp., Pfizer, Inc., Citigroup, Inc., Microsoft Corp.); (v) regarding component available shares, (a) the most available shares of a component is 10.77 billion shares (Microsoft Corp.), (b) the least available shares of a component is 118.91 million shares (M&T Bank Corp.), (c) the mean available shares of the components is 1.01 billion shares, and (d) the median available shares of the components is 455.63 million shares; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 64.6 million shares (Lucent Technologies, Inc.), (b) the lowest six month average daily volume of a component is 514,230 shares (William Wrigley Jr., Co.), (c) the mean six month average daily volume of the components is 5.292 million shares, (d) the median six month average daily volume of the components is 2.81 million shares, (e) the average of six month average daily volumes of the five most heavily traded components is 57.56 million shares (Lucent Technologies, Inc., Microsoft Corp., Intel Corp., Cisco Systems, Inc. & Sun Microsystems, Inc.), and (f) 100% of the components had a six month average daily volume of at least 50,000; and (vii) regarding option eligibility, (a) 99.2% of the components are options eligible, as measured by weighting, and (b) 97.2% of the components are options eligible, as measured by number.

ISE 100 Index

The ISE 100 Index tracks the 100 most actively traded listed options classes on the Exchange. Components of the ISE 100 Index are selected based on the average daily volume of each options class over a six-month period on the Exchange. Its original selection pool includes all equity options listed on the Exchange, ranked by average daily volume over the previous six month period. Companies that do not meet component eligibility requirements are removed.

The top 100 companies, ranked by average daily volume, are then selected, and the index is weighted by float-adjusted market capitalization.

Similar to the ISE 250 Index, each component's eligibility and ranking in the ISE 100 Index is reviewed twice annually, in June and December of each calendar year. Any necessary component changes are made after the close on the third Friday of June and December, and become effective at the opening on the next trading day. Changes to the ISE 100 Index will be announced on ISE's publicly available website five trading days prior to the effective date.

In addition to the scheduled reviews, the ISE 100 Index is reviewed on an ongoing basis to accommodate extraordinary events and corporate actions, such as delistings, bankruptcies, mergers or acquisitions involving index components.

As set forth in Exhibit 3 to the proposal, as of June 11, 2004, following are the characteristics of the ISE 100 Index: (i) the total capitalization of all of the components in the Index is \$5.36 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component is \$328.14 billion (General Electric Co.), (b) the lowest capitalization of a component is \$104.44 million (Genta, Inc.), (c) the mean capitalization of the components is \$53.65 billion, and (d) the median capitalization of the components is \$26.09 billion; (iii) regarding component price per share, (a) the highest price per share of a component is \$93.01 (Goldman, Sachs Group, Inc.), (b) the lowest price per share of component is \$2.27 (Genta, Inc.), (c) the mean price per share of the components is \$36.94, and (d) the median price per share of the components is \$31.59; (iv) regarding component weightings, (a) the highest weighting of a component is 6.1% (General Electric Co), (b) the lowest weighting of a component is 0.002% (Genta, Inc.), (c) the mean weighting of the components is 1.0%, (d) the median weighting of the components is 0.5%, and (e) the total weighting of the top five highest weighted components is 25.6% (General

Electric Co., Exxon Mobil Corp., Pfizer, Inc., Citigroup, Inc., Microsoft Corp.); (v) regarding component available shares, (a) the most available shares of a component is 10.77 billion shares (Microsoft Corp.), (b) the least available shares of a component is 39.05 million shares (Osi Pharmaceuticals, Inc.), (c) the mean available shares of the components is 1.67 billion shares, and (d) the median available shares of the components is 924.04 million shares; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 64.6 million shares (Lucent Technologies, Inc.), (b) the lowest six month average daily volume of a component is 981,490 shares (Reynolds American, Inc.), (c) the mean six month average daily volume of the components is 11.58 million shares, (d) the median six month average daily volume of the components is 6.84 million shares, (e) the average of six month average daily volumes of the five most heavily traded components is 60.08 million shares (Lucent Technologies, Inc., Microsoft Corp., Intel Corp., Sirius Satellite Radio, Inc. & Cisco Systems, Inc.), and (f) 100% of the components had a six month average daily volume of at least 50,000; (vii) regarding option eligibility, (a) 100% of the components are options eligible, as measured by weighting, and (b) 100% of the components are options eligible, as measured by number.

ISE 50 Index

The ISE 50 Index is a subset of the ISE 250 Index, such that the components of the ISE 50 Index consist of the top 50 components that make up the ISE 250 Index, as ranked by market capitalization. Thus, the criteria for inclusion into the ISE 50 Index, as well as the maintenance of the Index, are identical to those of the ISE 250 Index.

As set forth in Exhibit 3 to the proposal, as of June 11, 2004, following are the characteristics of the ISE 50 Index: (i) the total capitalization of all of the components in the

Index is \$5.18 trillion; (ii) regarding component capitalization, (a) the highest capitalization of a component is \$328.14 billion (General Electric, Co.), (b) the lowest capitalization of a component is \$24.86 billion (Motorola, Inc.), (c) the mean capitalization of the components is \$103.5 billion, and (d) the median capitalization of the components is \$73.7 billion; (iii) regarding component price per share, (a) the highest price per share of a component is \$93.01 (Goldman, Sachs Group, Inc.), (b) the lowest price per share of a component is \$11.71 (Oracle Corp.), (c) the mean price per share of the components is \$47.57, and (d) the median price per share of the components is \$45.67; (iv) regarding component weightings, (a) the highest weighting of a component is 6.3% (General Electric Co.), (b) the lowest weighting of a component is 0.5% (Goldman, Sachs Group, Inc.), (c) the mean weighting of the components is 2.0%, (d) the median weighting of the components is 1.4%, and (e) the total weighting of the top five highest weighted components is 26.5% (General Electric Co., Exxon Mobil Corp., Pfizer, Inc., Citigroup Inc., Microsoft Corp.); (v) regarding component available shares, (a) the most available shares of a component is 10.77 billion shares (Microsoft Corp.), (b) the least available shares of a component is 480.65 million shares (Goldman, Sachs Group, Inc.), (c) the mean available shares of the components is 2.74 billion shares, and (d) the median available shares of the components is 1.97 billion shares; (vi) regarding the six month average daily volumes of the components, (a) the highest six month average daily volume of a component is 62.59 million shares (Microsoft Corp.), (b) the lowest six month average daily volume of a component is 2.38 million shares (ConocoPhillips), (c) the mean six month average daily volume of the components is 11.63 million shares, (d) the median six month average daily volume of the components is 6.64 million shares, (e) the average of six month average daily volumes of the five most heavily traded components is 49.40 million shares (Microsoft Corp., Intel Corp., Cisco Systems, Inc.,

Oracle Corp. & General Electric, Co.), and (f) 100% of the components had a six month average daily volume of at least 50,000; (vii) regarding option eligibility, (a) 100% of the components are options eligible, as measured by weighting, and (b) 100% of the components are options eligible, as measured by number.

Index Calculation and Index Maintenance

The base index level of the ISE 250 Index, the ISE 100 Index and the ISE 50 Index, as of December 31, 1998, was 250, 100 and 200, respectively. On January 3, 2005, the index level of the ISE 250 Index, the ISE 100 Index and the ISE 50 Index was 227.48, 86.32, and 156.98, respectively. The Exchange proposes to base trading in options on both Full-size ISE Indexes and on fractions of Full-size ISE Indexes. In particular, the Exchange proposes to list options on Mini ISE Indexes that are based on one-tenth of the value of Full-size ISE Indexes. The Exchange believes that listing options on reduced values will attract a greater source of customer business than if options were based only on the full value of the ISE Indexes. The Exchange further believes that listing options on reduced values will provide an opportunity for investors to hedge, or speculate on, the market risk associated with the stocks comprising the ISE Indexes. Additionally, by reducing the values of the ISE Indexes, investors will be able to use this trading vehicle while extending a smaller outlay of capital. The Exchange believes that this should attract additional investors, and, in turn, create a more active and liquid trading environment.⁸

⁸ The concept of listing reduced value options on an index is not a novel one. See, e.g., Securities Exchange Act Release Nos. 32893 (September 14, 1993), 58 FR 49070 (September 21, 1993) (order approving File No. SR-CBOE-93-12) (approving the listing and trading of options based on one-tenth the value of the S&P 500 Index); 43000 (June 30, 2000), 65 FR 42409 (July 10, 2000) (notice of filing and immediate effectiveness of File No. SR-CBOE-00-15) (listing and trading of options based on one-tenth of the value of the Nasdaq 100 Index); and 48681 (October 22, 2003), 68 FR 62337 (November 3, 2003) (order approving File No. SR-CBOE-2003-14) (approving the listing and trading of options based on one-tenth of the value of the NYSE Composite Index).

The Full-size ISE Indexes' and the Mini ISE Indexes' level shall each be calculated continuously, using the last sale price for each component stock in the ISE Indexes, and shall be disseminated every 15 seconds throughout the trading day.⁹ To calculate the value of the Full-size ISE Indexes, the sum of the market value of the stocks in the ISE Indexes is divided by the base period market value (divisor). To calculate the value of the Mini ISE Indexes, the full value of the ISE Indexes is divided by ten. In order to provide continuity for the ISE Indexes' value, the divisor is adjusted periodically to reflect such events as changes in the number of common shares outstanding for component stocks, company additions or deletions, corporate restructurings and other capitalization changes.

The settlement values for purposes of settling both Full-size ISE Indexes ("Full-size Settlement Value") and Mini ISE Indexes ("Mini Settlement Value") shall be calculated on the basis of opening market prices on the business day prior to the expiration date of such options ("Settlement Day").¹⁰ The Settlement Day is normally the Friday preceding "Expiration Saturday."¹¹ In the event a component security in the ISE Indexes does not trade on Settlement Day, the closing price from the previous trading day will be used to calculate both Full-size Settlement Value and Mini Settlement Value. Accordingly, trading in the ISE Indexes will normally cease on the Thursday preceding an Expiration Saturday. S&P shall calculate, and the Exchange shall disseminate, both Full-size Settlement Value and Mini Settlement Value in the

⁹ The ISE Index levels shall be calculated by S&P, on behalf of the Exchange, and disseminated to the Options Price Reporting Authority ("OPRA") by the Exchange. The Exchange shall also disseminate these values to its members. The ISE Indexes will be published daily on the Exchange's publicly available website and through major quotation vendors, such as Reuters.

¹⁰ The aggregate exercise value of the option contract is calculated by multiplying the Index value by the Index multiplier, which is 100.

¹¹ For any given expiration month, options on the ISE Indexes will expire on the third Saturday of the month.

same manner as S&P shall calculate, and the Exchange shall disseminate, both Full-Size ISE Indexes' and Mini ISE Indexes' level.

S&P will monitor and maintain the ISE Indexes pursuant to ISE's methodology and instructions. S&P is responsible for making all necessary adjustments to the ISE Indexes to reflect component deletions, share changes, stock splits, stock dividends (other than an ordinary cash dividend), and stock price adjustments due to restructuring, mergers, or spin-offs involving the underlying components. Some corporate actions, such as stock splits and stock dividends, require simple changes to the available shares outstanding and the stock prices of the underlying components. The number of common shares outstanding for each component stock will be reviewed every Friday. Share changes of less than 5% will be updated on a quarterly basis, becoming effective after the close on the third Friday of March, June, September and December of each calendar year. The index divisor is adjusted at that time to compensate for the share changes. Share changes greater than 5% will be adjusted after the close on the Wednesday of the following week. The index divisor change also becomes effective after the close on that day. Changes will be announced on the Exchange's publicly available website prior to the effective date. Unscheduled share changes due to corporate actions may be processed the same day they are announced, depending on the time the details are received by S&P. In such cases, the index divisor changes may become effective that same day and immediately announced on the Exchange's publicly available website.

The eligibility of each component of the ISE Indexes will be reviewed in June and December of each calendar year. Components that fail to meet the eligibility requirements are replaced with new component companies. Component changes may also occur between review periods if a specific corporate action makes an existing component ineligible. The Exchange

maintains a Component Replacement Pool (“CRP”) for the ISE Indexes at all times for contingency purposes. The CRP contains at least ten companies that meet the eligibility requirements for the ISE Indexes, ranked by market capitalization for the ISE 250 Index and the ISE 50 Index, and six-month average trading volume for the ISE 100 Index. Components removed from the ISE Indexes are replaced with those from the CRP. Component changes are made after the close on the third Friday of June and December of each calendar year, and become effective at the opening on the next trading day. All such changes will be announced on the Exchange’s publicly available website at least five trading days prior to the effective date.

The Exchange represents that the ISE Indexes currently satisfy the maintenance criteria and further states that it will monitor and maintain the ISE Indexes on a quarterly basis, at which point the Exchange will notify the Market Regulation Division of the Commission if: (i) the number of securities in the ISE Indexes drops by 1/3 or more; (ii) 10% or more of the weight of the ISE Indexes is represented by component securities having a market value of less than \$75 million; (iii) less than 80% of the weight of the ISE Indexes is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (iv) 10% or more of the weight of the ISE Indexes is represented by component securities trading less than 20,000 shares per day; or (v) the largest component security accounts for more than 15% of the weight of the ISE Indexes or the largest five components in the aggregate account for more than 40% of the weight of the ISE Indexes.¹² In the event the Indexes fail at any time to satisfy the maintenance criteria, the ISE will not open for trading any additional series of options on the Indexes unless such failure is determined by the Exchange not to be significant and the Commission concurs in

¹² The timeframe for monitoring the ISE Indexes was changed from an annual to a quarterly basis. Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and Mia Zur, Attorney, Division of Market Regulation (“Division”), Commission (March 22, 2005).

that determination, or unless the continued listing of options on each respective Index has been approved by the Commission under Section 19(b)(2) of the Exchange Act.¹³

Contract Specifications

The contract specifications for options on the ISE Indexes are set forth in Exhibit 3 to the proposal. The ISE Indexes are each broad-based indexes, as defined in ISE Rule 2001(j).¹⁴ Options on the ISE Indexes are European-style and A.M. cash-settled. The Exchange's standard trading hours for index options (9:30 a.m. to 4:15 p.m., New York time), as set forth in ISE Rule 2008(a), will apply to the ISE Indexes. Exchange rules that are applicable to the trading of options on broad-based indexes will apply to both Full-size ISE Indexes and Mini ISE Indexes.¹⁵ Specifically, the trading of Full-size ISE Indexes and Mini ISE Indexes will be subject to, among others, Exchange rules governing margin requirements and trading halt procedures for index options.

For each of the Full-size ISE Indexes, the Exchange proposes to establish aggregate position and exercise limits at 50,000 contracts on the same side of the market, provided no more than 30,000 of such contracts are in the nearest expiration month series. For position and exercise limit purposes, Full-size ISE Indexes contracts shall be aggregated with Mini ISE Indexes contracts, where ten (10) Mini ISE Indexes contracts equal one (1) Full-size ISE Index contract.

¹³ Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and Mia Zur, Attorney, Division, Commission (March 22, 2005).

¹⁴ ISE Rule 2001(j) defines a "market index" or a "broad-based index" to mean an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries.

¹⁵ See ISE Rules 2000 through 2012.

The Exchange proposes to apply index margin requirements for the purchase and sale of options on the ISE Indexes. Accordingly, purchases of put or call options with 9 months or less until expiration must be paid for in full. Writers of uncovered put or call options must deposit/maintain 100% of the option proceeds, plus 15% of the aggregate contract value (current index level x \$100), less any out-of-the-money amount, subject to a minimum of the option proceeds plus 10% of the aggregate contract value for call options and a minimum of the option proceeds plus 10% of the aggregate exercise price amount for put options.

The Exchange proposes to set strike price intervals at 2½ points for certain near-the-money series in near-term expiration months when each of the ISE Indexes is at a level below 200, and 5 point strike price intervals for other options series with expirations up to one year, and 10 point strike price intervals for longer-term options. The minimum tick size for series trading below \$3 shall be 0.05, and for series trading at or above \$3 shall be 0.10.

The Exchange proposes to list options on the ISE Indexes in the three consecutive near-term expiration months plus up to three successive expiration months in the March cycle. For example, consecutive expirations of January, February, March, plus June, September, and December expirations would be listed.¹⁶ In addition, longer-term option series (“LEAPS”) having up to thirty-six (36) months to expiration may be traded.¹⁷ The interval between expiration months on the ISE Indexes shall not be less than six months. The trading of any long-term ISE Indexes shall be subject to the same rules that govern the trading of all the Exchange’s

¹⁶ See ISE Rule 2009(a)(3).

¹⁷ See ISE Rule 2009(b)(1). LEAPS will be available on the Full and Reduced Value ISE Indexes. However, the Exchange is not listing reduced value LEAPS on the Reduced Value ISE Indexes pursuant to ISE Rule 2009(b)(2). Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and Mia Zur, Attorney, Division, Commission (March 11, 2005).

index options, including sales practice rules, margin requirements, trading rules and position and exercise limits.

Surveillance and Capacity

The Exchange represents that it has an adequate surveillance program in place for options traded on the ISE Indexes, and intends to apply those same program procedures that it applies to the Exchange's other index options. Additionally, the Exchange is a member of the Intermarket Surveillance Group ("ISG") under the Intermarket Surveillance Group Agreement, dated June 20, 1994. The members of the ISG include all of the U.S. registered stock and options markets: the Amex, the Boston Stock Exchange, Inc. ("BSE"), the Chicago Board Options Exchange ("CBOE"), the Chicago Stock Exchange, Inc. ("CSE"), the National Stock Exchange, Inc. ("NSE"), the NASD, the NYSE, the Pacific Stock Exchange, Inc. ("PSE") and the Philadelphia Stock Exchange, Inc. ("PHLX"). The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets. In addition, the major futures exchanges are affiliated members of the ISG, which allows for the sharing of surveillance information for potential intermarket trading abuses.

The Exchange represents that it has the system capacity to adequately handle all series that would be permitted to be added by this proposal (including LEAPS). The Exchange provided to the Commission information in a confidential submission that supports its system capacity representations that will result from the introduction of both Full-size ISE Indexes and Mini ISE Indexes.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹⁸ in general, and furthers the objectives of Section 6(b)(5),¹⁹ in particular, in that it will permit options trading in Full-size ISE Indexes and Mini ISE Indexes pursuant to rules designed to prevent fraudulent and manipulative acts and practices and promote just and equitable principals of trade.

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

The ISE believes that the proposed rule change does not impose any burden on competition.

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 self-regulatory organization 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.

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, 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-2004-28 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-ISE-2004-28. 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 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-2004-28 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).