

changes in the common shares outstanding and the stock prices of the companies in the Index. Other corporate actions, such as share issuances, change the market value of the Index and require an Index Divisor adjustment as well.

Although ISE is not involved in the maintenance of the Index, it represents that it will monitor the Index semi-annually and will notify Commission staff in the event that (1) 10% of the capitalization of the Index is comprised of securities with a market capitalization of less than \$100 million; (2) 10% of the capitalization of the Index is made up of components with an average daily trading volume of less than 10,000 shares over the previous six months; or (3) non-U.S. component securities (common stock or ADRs) that are not subject to a comprehensive surveillance agreement in the aggregate represent more than 20% of the weight of the Index's aggregate market capitalization.

d. Index Options Trading.

In addition to regular Index options, the Exchange may provide for the listing of long-term (up to three years expiration) index options series and reduced-value long-term index options on the Index. For reduced-value long-term index options, the underlying value would be computed at one-tenth of the Index level. The current and closing index value of any such reduced-value long-term index option will, after such initial computation, be rounded to the nearest one-hundredth.

The Exchange seeks to have the discretion to list series in 2½ point intervals when the Index level falls below 200. The minimum tick size (trading interval) for series trading below \$3 will be \$.05 (\$5.00) and for series trading above \$3 will be \$.10 (\$10.00). The trading hours for options on the Index will be from 9:30 a.m. to 4:15 p.m. Eastern time.⁷

e. Exercise and Settlement.

The options on the Index will be European-style index options that expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 4:15 p.m. Eastern time on the immediately preceding Thursday.⁸ The Index multiplier will be

100. The exercise settlement value of the Index at option expiration will be calculated by Standard & Poor's based on the opening prices of the component securities on the business day prior to expiration ("A.M. Settlement"). If a stock fails to open for trading, the last available price on the stock will be used in the calculation of the index.

f. Position Limits.

The Exchange proposes to establish position limits for options on the S&P Small Cap 600 at 100,000 contracts on either side of the market, and no more than 60,000 of such contracts may be in the series in the nearest expiration month. The hedge exemption for this broad-based Index will be an additional 75,000 contracts.

g. Exchange Rules Applicable.

As modified herein, the Exchange Rules in Chapter 20 will be applicable to S&P Small Cap 600 options.

h. Surveillance.

The Exchange conducts routine surveillance for trading of equity options and has, where appropriate, incorporated all index options into its program. In addition, the Exchange has developed surveillance procedures specific to index options, which have been provided to the Commission. The ISE believes these procedures are adequate to properly monitor trading in options on the S&P Small Cap 600.⁹ For surveillance purposes, the Exchange will have complete access to information regarding trading activity in the underlying securities. In addition, the Intermarket Surveillance Group Agreement ("ISG Agreement"), dated June 20, 1994, will be applicable to the trading of options on the Index.¹⁰

i. Capacity.

ISE believes it has the necessary systems capacity to support new series that will result from the introduction of S&P Small Cap 600 index options. ISE has also been informed that the Options Price Reporting Authority ("OPRA")

believes that it has the capacity to support such new series.¹¹

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with section 6(b) of the Act¹² in general, and furthers the objectives of section 6(b)(5),¹³ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change, as amended, will 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 did not receive any written comments on the proposed rule change, as amended.

III. 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to the File No. SR-ISE-2003-18 and should be submitted by October 29, 2003.

⁹ See Amendment No. 1, *supra* note 3.

¹⁰ The ISE is a member of the Intermarket Surveillance Group ("ISG") under the ISG Agreement, dated June 20, 1994. The members of the ISG include all of the U.S. registered stock and options markets: the American Stock Exchange LLC ("Amex"), the Boston Stock Exchange ("BSE"), the Chicago Board of Options Exchange ("CBOE"), the Chicago Stock Exchange ("CHX"), the Cincinnati Stock Exchange ("CSE"), the National Association of Securities Dealers ("NASD"), the New York Stock Exchange, Inc. ("NYSE"), the Pacific Stock Exchange ("PCX") and the Philadelphia Stock Exchange ("Phlx"). The ISE 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. See Amendment No. 1, *supra* note 3.

¹¹ See letter from Joseph P. Corrigan, Executive Director, OPRA to Kathy Simmons, Vice President, Legal & Regulatory, ISE, dated August 28, 2003.

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

⁷ Telephone conference between Katherine Simmons, Vice President and Associate General Counsel, ISE, and Florence Harmon, Senior Special Counsel, Division, Commission, on October 1, 2003.

⁸ When the last trading day is moved because of Exchange holidays (such as when ISE is closed on the Friday before expiration), the last trading day for expiring options will be Wednesday and the exercise settlement value of Index options at expiration will be determined at the opening of regular Thursday trading.