

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47293; File No. SR-ISE-2002-19]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by International Securities Exchange, Inc., Relating to Rules Governing the Intermarket Linkage, and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Thereto

January 31, 2003.

#### I. Introduction

On September 24, 2002, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt new Chapter 19 of its rules, governing the operation of the intermarket linkage (the "Linkage"). The proposed rule change was published for comment in the **Federal Register** on December 26, 2002.<sup>3</sup> The Commission received no comments on the proposed rule change. On January 28, 2003, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change, provides notice of filing of Amendment No. 1 and grants accelerated approval to Amendment No. 1.

#### II. Description of Proposal

In general, the proposed rules contain relevant definitions, establish the conditions pursuant to which market makers may enter Linkage orders, impose obligations on the Exchange regarding how it must process incoming Linkage orders, and establish a general standard that members should avoid

trade-throughs.<sup>5</sup> The proposed rules establish potential regulatory liability for members who engage in a pattern or practice of trading through other exchanges, whether or not the exchanges traded through participate in the Linkage, provide procedures to unlock and uncross markets, and codify the "80/20 Test" contained in section 8(b)(iii) of the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage (the "Plan"),<sup>6</sup> which provides that a market maker on an Exchange would be restricted from sending principal orders (other than P/A orders, which reflect unexecuted customer orders) through the Linkage if the market maker effects less than 80 percent of specified order flow on the Exchange. The proposed rule change also establishes a fee, which will apply to Principal Orders and Principal Acting as Agent Orders. These fees are the same fees applicable to ISE market makers.

#### III. Discussion

The Commission has reviewed the ISE's proposed rule change and finds that the proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,<sup>7</sup> and with the requirements of section 6(b).<sup>8</sup> In particular the Commission finds that the proposed rule change is designed 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 in securities, 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 in accordance with section 6(b)(5) of the Act.<sup>9</sup> The Commission also finds that the proposed fee change is consistent with section 6(b)(4) of the Act<sup>10</sup> in that it represents an equitable allocation of

reasonable dues, fees and other charges among its members and other persons using its facilities.

The Commission believes that the rules proposed by the ISE will adequately govern the operation of the Linkage as envisioned in the Plan. The Commission believes that these rules will help to ensure that the Linkage is operated fairly and effectively, in accordance with the principles of the Act and the Plan.

The Commission also finds good cause for approving proposed Amendment No. 1 prior to the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 proposes several changes to the Exchange's original proposal that are designed to conform the Exchange's rules governing linkage more closely to the Plan. The provisions of the Plan have already been subject to notice and comment, and have been approved by the Commission. The changes proposed in Amendment No. 1 do not raise any novel regulatory issues, and therefore, it is appropriate for the Commission to accelerate approval of Amendment No. 1.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1 to the proposed rule change, including whether Amendment No. 1 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 Amendment No. 1 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 File No. SR-ISE-2002-19 and should be submitted by February 27, 2003.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (SR-ISE-2002-19), be, and hereby is, approved, and that Amendment No. 1 to the proposed

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 47029 (December 18, 2002), 67 FR 78834.

<sup>4</sup> See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated January 27, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange proposed to amend: (1) The definition of "Linkage Order" contained in ISE rule 1900 to state that such orders are immediate or cancel orders; (2) ISE rule 1901 to clarify when members may send linkage orders when markets are non-firm; (3) ISE rule 1901 to include a provision regarding mitigation of damages; (4) ISE rule 1902 to clarify language regarding liability for trade-throughs at the end of the trading day and to request approval of this provision only for a one-year pilot period; and (5) ISE rule 1902 to clarify that members may not engage in a pattern or practice of trading through.

<sup>5</sup> Trade-throughs occur when broker-dealers execute customer orders on one exchange at prices inferior to another exchange's disseminated quote.

<sup>6</sup> Approved by the Commission in Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000), as subsequently amended. See Securities Exchange Act Release No. 44482 (June 27, 2001), 66 FR 35470 (July 5, 2001) ("Initial Amendment Order") and Securities Exchange Act Release No. 46001 (May 30, 2002), 67 FR 38687 (June 5, 2002); 47274 (January 29, 2003); and 47298 (January 31, 2003).

<sup>7</sup> In approving this rule proposal, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 15 U.S.C. 78f(b)(4).

<sup>11</sup> 15 U.S.C. 78s(b)(2).