

material to the overall proposal. The Commission believes that little purpose would be served by delaying approval of the proposal until those additional revisions had been published for comment. The Commission believes that it has received and fully considered substantial, meaningful comments with respect to the BSE's proposal, as amended, and that Amendment No. 4 does not raise issues that warrant further delay. Accordingly, pursuant to section 19(b)(2) of the Act,<sup>307</sup> the Commission finds good cause to approve Amendment No. 4 prior to the 30th day after notice of the Amendment is published in the **Federal Register**.

## VII. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with section 6(b)(5) of the Act.<sup>308</sup>

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>309</sup> that the proposed rule change (SR-BSE-2002-15), as amended, is hereby finally approved, and Amendment No. 4 to the proposed rule change is hereby granted accelerated approval.

Although, the Commission's approval of the BSE's proposed rule change to establish trading rules for the BOX facility is final, it will not be effective until the BSE takes the following actions:

(1) *Participation in the Options Self-Regulatory Council ("OSRC")*. The BSE must become a signatory to the 17d-2 agreement administered by the OSRC, which is a plan for the allocation of regulatory responsibility approved by the Commission under Rule 17d-2 of the Exchange Act.

(2) *Participation in the National Market System Plans relating to options trading*. The BSE must join the Options Price Reporting Authority, the Options Listing Procedures Plan, and the Options Linkage Authority.

(3) *Examination by the Commission*. The BSE must demonstrate to the satisfaction of Commission staff in the Office of Compliance Inspections and Examinations ("OCIE") that it has

adequate surveillance programs and procedures in place to monitor trading on BOX and that BOX Options Participants can comply with the trade-through requirements of the Linkage Plan with regard to all trades effected through BOX or any exemption from such Linkage Plan requirements. OCIE shall evidence its satisfaction by issuing a letter to the BSE.

(4) The BSE must file a separate proposed rule change with the Commission pursuant to section 19(b) of the Act,<sup>310</sup> to amend the BOX Rules as follows:<sup>311</sup>

- *Market Opening*. As noted above, the BSE must amend Chapter V, section 9 of the proposed BOX Rules relating to the market opening to provide a more detailed description of the market opening procedures. Among other things, the BSE must clarify the proposed procedures for determining an opening price, including the pre-opening and the Theoretical Opening Price. In addition, the BSE must add a provision relating to the interaction of Customer Orders during the market opening.

- *Anticipatory Hedging*. As noted above, the BSE must amend the proposed BOX Rules to prohibit any person associated with an Options Participant who has knowledge of all material terms and conditions of (i) an order and a solicited order, (ii) an order being facilitated, or (iii) orders being crossed, the execution of which are imminent, to enter, based on such knowledge, an order to buy/sell the option, the underlying security, or any related instrument until the terms are disclosed to the trading crowd or the trade can no longer be considered imminent.

- *Exercise of Options Contracts*. The BSE must amend Chapter VII, section 1 of the proposed BOX Rules to clarify the provisions relating to contrary exercise advice.

- *Complex Orders*. As noted above, the BSE must amend the proposed BOX rules to specify the process for BOX Participants to notify BOX of a proposed strategy and the procedure for sending advisory messages.

Each of these conditions to file proposed rule changes will be satisfied upon effectiveness under section 19(b) of the Act.

<sup>310</sup> 15 U.S.C. 78s(b).

<sup>311</sup> The Commission is requiring these amendments so that the BOX Rules are comparable with the rules of the other options exchanges.

By the Commission.

**Margaret H. McFarland**,  
*Deputy Secretary*.

[FR Doc. 04-1117 Filed 1-16-04; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49056; File No. SR-ISE-2003-07]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by International Securities Exchange, Inc., Relating to Pricing of Block and Facilitation Trades

January 12, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 25, 2003, 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 self-regulatory organization. On December 18, 2003, the Exchange amended the proposed rule change. 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 provide for the entry and execution of block and facilitation trades at the midpoint between the standard trading increments. The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

#### Rule 716. Block Trades

\* \* \* \* \*

(a) Block-Size Orders. Block-size orders are orders for fifty (50) contracts or more.

(b) For purposes of this Rule, a "broadcast message" means an electronic message that is sent by the Exchange to all Members, and a "Response" means an electronic message that is sent by Members in response to a broadcast message [the term "Crowd Participants" means the market makers appointed to an options class under Rule 803, as well as other

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

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

<sup>307</sup> 15 U.S.C. 78s(b)(2).

<sup>308</sup> 15 U.S.C. 78f(b)(5). In connection with the issuance of this approval order, neither the Commission nor the staff is granting any exemptive or no-action relief from the requirements of Rule 10b-10 under the Act. 17 CFR 240.10b-10. Accordingly, a broker-dealer executing a customer order through BOX will need to comply with all applicable requirements of this Rule.

<sup>309</sup> 15 U.S.C. 78s(b)(2).

Members with proprietary orders at the inside bid or offer for a particular series].

(c) Block Order Mechanism. The Block Order Mechanism is a process by which a Member can obtain liquidity for the execution of block-size orders.

(1) Upon the entry of an order into the Block Order Mechanism, a broadcast message will be sent *and Members* [to the Crowd Participants, which] will be given an opportunity to *enter Responses* [respond to the broadcast message (a "Response")] with [indications of] the prices and sizes at which they would be willing to trade with a block-size order.

(2) At the conclusion of the time given [Crowd Participants] *Members* to enter Responses, either an execution will occur automatically, or the order will be cancelled.

(i) No change.

(ii) No change.

(iii) No change.

(d) Facilitation Mechanism. The Facilitation Mechanism is a process by which an Electronic Access Member can facilitate block-size Public Customer Orders. Electronic Access Members must be willing to facilitate the entire size of orders entered into the Facilitation Mechanism.

(1) Upon the entry of an order into the Facilitation Mechanism, a broadcast message will be sent [to the crowd Participants, which] *and Members* will be given an opportunity to *enter Responses with the prices and sizes at which* [indicate whether] they want to participate in the facilitation of the [Public Customer] order [at the facilitation price (an "Indication")].

(2) [Indications] *Responses* may be priced at the price of the order to be facilitated or at a better price[, so long as such better price is to buy (sell) at a price that is below (above) the ISE best bid (offer),] and must not exceed the size of the order to be facilitated.

[(3) Crowd Participants may indicate a willingness to facilitate an order at an improved price that is equal to or higher (lower) than the best bid (offer) on the Exchange by entering orders or changing their quotes, as applicable.]

[(4)] (3) At the end of the period given for the entry of *Responses* [Indications], the facilitation order will be automatically executed in full.

(i) Unless there is sufficient size to execute the entire facilitation order at a better price, Public Customer bids (offers) [on the Exchange] at the time the facilitation order is executed that are priced higher (lower) than the facilitation price will be executed at the facilitation price. Non-Customer bids (offers) [on the Exchange] at the time the facilitation order is executed that are

priced higher (lower) than the facilitation price will be executed at their stated price, thereby providing the order being facilitated a better price for the number of contracts associated with such higher bids (lower offers).

(ii) The facilitating Electronic Access Member will execute at least forty percent (40%) of the original size of the facilitation order, but only after better-priced orders and quotes, as well as Public Customer Orders at the facilitation price are executed. [Indications] Responses, quotes and Non-Customer Orders at the facilitation price will participate in the execution of the facilitation order based upon the percentage of the total number of contracts available at the best price that is represented by the size of the Non-Customer Order or quote.

#### Supplementary Material to Rule 716

.01 It will be a violation of a Member's duty of best execution to its customer if it were to cancel a facilitation order to avoid execution of the order at a better price. The availability of the Facilitation Mechanism does not alter a Member's best execution duty to get the best price for its customer. Accordingly, while facilitation orders can be canceled during the time period given for the entry of [Indications] *Responses*, if a Member were to cancel a facilitation order when there was a superior price available on the Exchange and subsequently re-enter the facilitation order at the same facilitation price after the better price was no longer available without attempting to obtain that better price for its customer, there would be a presumption that the Member did so to avoid execution of its customer order in whole or in part by other brokers at the better price.

.02 Responses represent non-firm interest that can be canceled at any time prior to execution. Responses are not displayed to any market participants.

.03 *Responses may not be entered for the account of an options market maker from another options exchange.*

.04 The time given to [Crowd Participants] *Members* to enter Responses under paragraph (c)(1) shall be thirty (30) seconds, and for [Indications] *Responses* entered under paragraph (d)(1) shall be ten (10) seconds.

.05 *Split Prices. Orders and Responses may be entered into the Block, Solicited Order and Facilitation Mechanisms and receive executions at the mid-price between the standard minimum trading increments for the options series ("Split Prices"). This means that orders and Responses for*

*options with a minimum increment of 5 cents may be entered into the Block, Solicited Order and Facilitation Mechanisms and receive executions in 2.5 cent increments (e.g., \$1.025, \$1.05, \$1.075, etc.), and that orders and Responses for options with a minimum increment of 10 cents may be entered into the Block, Solicited Order and Facilitation Mechanism and receive executions at 5 cent increments (e.g., \$4.05, \$4.10, \$4.15, etc.). Orders and quotes in the market that receive the benefit of the block execution price under paragraph (c)(2)(i) and facilitation price under paragraph (d)(2)(i) may also receive executions at Split Prices.*

\* \* \* \* \*

## 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 Exchange 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 Exchange 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 purpose of this proposed rule change is to permit the ISE to execute and report block and facilitation trades at prices that are priced at the midpoint between the standard \$.05 and \$.10 trading increments (a "Split Price"). The ISE believes that this would provide ISE members with greater flexibility in the pricing of their block-size trades and allow a greater opportunity for price improvement for large-size orders. The ISE also believes that the proposed rule change also would provide a mechanism to allow the ISE to be competitive with the floor-based exchanges where there are informal procedures that permit trades to effectively receive Split Prices.

Specifically, the Exchange proposes to allow orders to be entered into the Block and Facilitation Mechanisms in \$.025 increments for options with a standard minimum trading increment of \$.05 (e.g., \$1.025, \$1.05, \$1.075, etc.) and in \$.05 increments for options with a standard minimum trading increment of

\$.10 (e.g., \$4.05, \$4.10, \$4.15, etc.). In addition, Exchange members would be able to respond to a Block or Facilitation broadcast message in \$.025 increments for options with a minimum trading increment of \$.05 and in \$.05 increments for options with minimum trading increment of \$.10, whether or not the order is entered at a standard increment. For example, if an order to sell 500 contracts were to be entered into the Facilitation Mechanism at a price of \$4.00, members would be able to respond with a price of \$4.05. If an order were to be executed at a Split Price, the Exchange would report the trade with the Split Price to the Options Price Reporting Authority ("OPRA"). The trade would be cleared by The Options Clearing Corporation ("OCC") at the Split Price as well.

In connection with the proposal to allow Split Prices in the Block and Facilitation Mechanism, the Exchange also proposes to expand participation in the Block and Facilitation Mechanisms. Currently, when an order is entered into either Mechanism, a message is sent to "Crowd Participants," who are given a certain amount of time to respond if they are interested in participating in the block-size trade. "Crowd Participants" are ISE market makers appointed to the options class and other ISE members with proprietary orders at the inside bid or offer for a particular series. Instead of limiting the broadcast message to the Crowd Participants, the Exchange proposes to send a broadcast message to all members and permit all members to respond if they wish to participate in the block-size transaction. The Exchange proposes, however, to prohibit the entry of a response that is for the account of an options market maker from another options exchange. The Exchange believes that this narrow limitation is necessary because ISE market makers are not given an opportunity to participate in trades executed on the floors of the other options exchanges. As a result, ISE believes that its market makers would be at a competitive disadvantage if options market makers from other exchanges were given such opportunity at the ISE.

The ISE also proposes to eliminate a restriction on the price at which members are permitted to respond to an order entered into the Facilitation Mechanism. Under the current rule, Crowd Participants are only permitted to respond at the proposed facilitation price. If a Crowd Participant wants to provide a better price to the order being facilitated, it must enter an order or quote into the market. As the ISE is only proposing to allow Split Pricing for

block-size orders executed through the Block and Facilitation Mechanisms, it would be necessary to remove this limitation in order to allow members to respond at Split Prices.

Finally, the Exchange proposes to clarify the rule by providing definitions of a "broadcast message" and a "Response" and using those terms consistently throughout the rule. In addition, the proposal would add language to indicate that the Responses would represent non-firm interest that would be able to be canceled at any time prior to execution, and that Responses would not be displayed to any market participants. The ISE states that this has always been the case, but was not previously included in the text of the rule.

## 2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under section 6(b)(5)<sup>3</sup> that an exchange have rules that are designed 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. The Exchange believes that the proposed rule change would provide investors with greater flexibility to execute options orders in the ISE's electronic system at the same Split Prices they are able to obtain on the other options exchanges. The ISE believes the proposed rule change would also provide greater opportunity for price improvement of block-size orders.

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

This proposed rule change does not impose any burden on competition. Rather, it will allow the ISE to better compete with the other options exchanges for block-size orders.

### *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 the 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.

## **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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-ISE-2003-07. This file number should be included on the subject line if e-mail is used. To help the Commission process and review comments more efficiently, comments should be sent in hardcopy or by e-mail but not by both methods. 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 Section, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of such filing will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No. SR-ISE-2003-07 and should be submitted by February 10, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>4</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>3</sup> 15 U.S.C. 78f(b)(5).

<sup>4</sup> 17 CFR 200.30-3(a)(12).