

consultants after careful consideration of recommendations by commenters.

#### (b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

#### *B. Board's Statement on Burden on Competition*

The Board does not believe that the proposed rules will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### *C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others*

The Board released its proposed Code for public comment on April 18, 2003. See PCAOB Release No. 2003-004 (April 18, 2003). The Board received eight written comment letters on its proposal. A copy of PCAOB Release No. 2003-004 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's Web site at [www.pcaobus.org](http://www.pcaobus.org).

The Board has carefully considered all comments it has received. In response to the written comments received, the Board clarified and modified certain aspects of its proposed Code. Specifically, the Board made 12 principal changes to its proposal. First, the Board revised its proposal to clarify that the Code's application to "designated contractors and consultants" will require a three step process: first, there must be a contract for services; second, the Board (or its designate) must determine that the Code should be applied to the contractor, in whole or in part; and last, the contract must contain specific provisions incorporating those portions of this Code applicable to the contractor. Second, the Board eliminated the definition of "immediate family" and clarified which provisions of the Ethics Code apply to a Board or staff member's spouse, spousal equivalent, and dependents. Third, the Board decided to impose the obligation upon Board members and professional staff to disclose their personal investments, and those of their spouses, spousal equivalents and dependents, in the securities of issuers.

Fourth, the Board decided to expand the narrow list of sponsors who are permitted to pay for Board-related travel to include associations of governmental (federal, state or local) bodies and non-U.S. institutions equivalent to the permissible domestic sponsors. Fifth, the Board created a "reasonable person" standard for Board members and professional staff to use to determine

whether a financial relationship requires disclosure and disqualification. Sixth, the Board clarified that, in the context of members of an advisory group,<sup>13</sup> independence and objectivity are not *per se* impaired because the group member's employer, business client or partner is subject to the Board's direct or indirect oversight.

Seventh, the revised Code clarifies that Board members and professional staff are not required to disqualify themselves from participating in making or developing broad policies or procedures which may have some effect on a former employer, business partner or client, so long as the policy or procedure effects all similarly situated people and organizations to the same degree. Eighth, the Board chose to define those circumstances which trigger (and do not trigger) the requirement for Board members and professional staff to internally disclose when they are "negotiating prospective employment" with a public accounting firm or issue.<sup>14</sup> Ninth, the Board required designated contractors and consultants to certify compliance with the Code (as applied to them) to the same extent as Board members and staff.

Tenth, the Board added a restriction on former Board members and professional staff participating in a matter they personally and substantially participated in while at the Board. Eleventh, the Board extended indefinitely the restriction on former Board members and professional staff from disclosing non-public Board information. Twelfth, and finally, the Board chose to make publicly available information on waivers of the Ethics Code. Additional discussion of the Board's response to these and other comments it received is included in section II(a)(A) above.

#### **III. Date of Effectiveness of the Proposed Rules 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 Board consents the Commission will:

(a) By order approve such proposed rules; or

<sup>13</sup> See PCAOB Release No. 2003-009, and PCAOB Rule 3700 (regarding advisory groups).

<sup>14</sup> When this disclosure is triggered, Board members and professional staff must also disqualify themselves from participating in decisions directly affecting the prospective employer.

(b) Institute proceedings to determine whether the proposed rules 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 rules are consistent with the requirements of Title I of 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 rules that are filed with the Commission, and all written communications relating to the proposed rules 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 PCAOB. All submissions should refer to File No. PCAOB-2003-04 and should be submitted by October 17, 2003.

By the Commission.

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

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#### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-48505; File No. SR-ISE-2003-20]

#### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the International Securities Exchange, Inc. To Simplify the Manner in Which a Contrary Exercise Advice Is Submitted and To Extend by One Hour the Time for Members To Submit Contrary Exercise Advices**

September 17, 2003.

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 August 12, 2003, the International Securities Exchange, Inc. ("ISE" or "Exchange") submitted to the Securities and

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

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

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 Exchange amended its proposal on September 9, 2003.<sup>3</sup> The Exchange filed the proposed rule change, as amended, under paragraph (f)(6) of Rule 19b-4 under the Act.<sup>4</sup> 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 Exchange proposes to amend ISE Rule 1100: (i) To simplify the manner in which a contrary exercise advice ("CEA") is submitted to the Exchange;<sup>5</sup> (ii) to extend by one hour the cut-off time for Members to submit CEAs to the Exchange; and (iii) to add new paragraphs (g) and (h) for the purpose of establishing different cut-off times for options holders to decide whether to exercise or not exercise an expiring option and for members to submit CEAs based on a modified trading session or due to "unusual circumstances." Below is the text of the proposed rule change, as amended. Proposed new language is *italicized*; proposed deleted text is [bracketed].

\* \* \* \* \*

### **Rule 1100. Exercise of Options Contracts**

(a) Subject to the restrictions set forth in Rule 413 (Exercise Limits) and to such restrictions as may be imposed pursuant to Rule 417 (Other Restrictions on Options Transactions and Exercises) or pursuant to the Rules of the Clearing Corporation, an outstanding options contract may be exercised during the time period specified in the Rules of the Clearing Corporation by the tender to the Clearing Corporation of an exercise notice in accordance with the Rules of the Clearing Corporation. An exercise notice may be tendered to the Clearing Corporation only by the Clearing Member in whose account such options contract is carried with the Clearing Corporation. *Members may establish fixed procedures as to the latest time*

*they will accept exercise instructions from customers.*

[(b) The exercise cut-off time for all noncash-settled options shall be 5:30 p.m. Eastern Time on the business day immediately prior to the expiration date. This is the latest time at which an exercise instruction for expiring noncash-settled options positions may be:

(1) prepared by a Clearing Member for positions in its proprietary trading account;

(2) submitted to a Clearing Member by a market maker or broker for positions in the market maker's account or the broker's error account; or

(3) accepted by a Member from any customer for its positions in the customer's account.]

*(b) Special procedures apply to the exercise of equity options on the last business day before their expiration ("expiring options"). Unless waived by the Clearing Corporation, expiring options are subject to the Exercise-by-Exception ("Ex-by-Ex") procedure under Clearing Corporation Rule 805. This Rule provides that, unless contrary instructions are given, option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to the Rules of the Clearing Corporation, the following Exchange requirements apply with respect to expiring options. Option holders desiring to exercise or not exercise expiring options must either:*

*(1) take no action and allow exercise determinations to be made in accordance with the Clearing Corporation's Ex-by-Ex procedure where applicable; or*

*(2) submit a "Contrary Exercise Advice" to the Exchange by the deadline specified in paragraph (c) below. A Contrary Exercise Advice is a communication either: (A) to not exercise an option that would be automatically exercised under the Clearing Corporation's Ex-by-Ex procedure, or (B) to exercise an option that would not be automatically exercised under the Clearing Corporation's Ex-by-Ex procedure. A Contrary Exercise Advice may be submitted by a Member by using the Exchange's Contrary Exercise Advice Form, the Clearing Corporation's ENCORE system, a Contrary Exercise Advice form of any other national securities exchange of which the firm is a member and where the option is listed, or such other method as the Exchange may prescribe. A Contrary Exercise Advice may be canceled by filing an "Advice Cancel" with the Exchange or resubmitted at any time up*

*to the submission cut-off times specified below.*

*(c) Exercise cut-off time. Option holders have until 5:30 p.m. Eastern Time on the business day immediately prior to the expiration date to make a final decision to exercise or not exercise an expiring option. For customer accounts, Members may not accept exercise instructions after 5:30 p.m. Eastern Time but have until 6:30 p.m. Eastern Time to submit a Contrary Exercise Advice. For non-customer accounts, Members may not accept exercise instructions after 5:30 p.m. Eastern Time but have until 6:30 p.m. Eastern Time to submit a Contrary Exercise Advice if such Member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Consistent with Supplemental Material .03, Members are required to submit a Contrary Exercise Advice by 5:30 p.m. for non-customer accounts if such Members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders.*

*(d) If the Clearing Corporation has waived the Ex-by-Ex procedure for an options class, Members must either:*

*(1) submit to the Exchange, a Contrary Exercise Advice, in a manner specified by the Exchange, within the time limits specified in paragraph (c) above if the holder intends to exercise the option; or*

*(2) take no action and allow the option to expire without being exercised.*

*In cases where the Ex-by-Ex procedure has been waived, the Rules of the Clearing Corporation require that Members wishing to exercise such options must submit an affirmative Exercise Notice to the Clearing Corporation, whether or not a Contrary Exercise Advice has been filed with the Exchange.*

*(e) A Member that has accepted the responsibility to indicate final exercise decisions on behalf of another Member or non-member broker-dealer shall take the necessary steps to ensure that such decisions are properly indicated to the Exchange. Such Member may establish a processing cut-off time prior to the Exchange's exercise cut-off time at which it will no longer accept final exercise decisions in expiring options from option holders for whom it indicates final exercise decisions. Each Member that indicates final exercise decisions through another broker-dealer is responsible for ensuring that final exercise decisions for all of its proprietary (including market maker) and public customer account positions*

<sup>3</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated September 6, 2003 ("Amendment No. 1"). In Amendment No. 1, the ISE added footnotes to clarify terminology used in its discussion and made technical corrections to its rule text.

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> The term CEA as used in the filing may also include "Advice Cancels." Advice Cancels are documents used to cancel CEAs. See Amendment No. 1, *supra* note 3.

are indicated in a timely manner to such broker-dealer.

[(c)] (f) Notwithstanding the foregoing, Members may [receive and Members may submit exercise instructions] make final exercise decisions after the exercise cut-off time but prior to expiration without having submitted a Contrary Exercise Advice in the circumstances listed below. A memorandum setting forth the circumstance giving rise to instructions after the exercise cut-off time shall be maintained by the Member and a copy thereof shall be [promptly] filed with the Exchange no later than 12:00 noon Eastern Time on the first business day following the respective expiration. An exercise [instruction] decision after the exercise cut-off time may be [received or submitted] made:

(1) in order to remedy mistakes or errors made in good faith; or

(2) where exceptional circumstances [relating to a customer's or associated person's ability to communicate exercise instructions to the Member (or the Member's ability to receive exercise instructions) prior to such cut-off time warrant such action] have restricted an option holder's ability to inform a Member of a decision regarding exercise, or a Member's ability to receive an option holder's decision by the cut-off time. The burden of establishing any of the above exceptions rests solely on the Member seeking to rely on such exceptions.

(g) In the event the Exchange provides advance notice on or before 5:30 p.m. Eastern Time on the business day immediately prior to the last business day before the expiration date indicating that a modified time for the close of trading in equity options on such last business day before expiration will occur, then the deadline to make a final decision to exercise or not exercise an expiring option shall be 1 hour 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. Eastern Time deadline found in Rule 1100(c). However, Members may deliver a Contrary Exercise Advice or Advice Cancel to the Exchange within 2 hours 28 minutes following the time announced for the close of trading in equity options on that day instead of the 6:30 p.m. Eastern Time deadline found in Rule 1100(c) for customer accounts and non-customer accounts where such Member employs an electronic submission procedure with time stamp for the submission of exercise instructions. For non-customer accounts, Members that do not employ an electronic procedure with time stamp for the submission of exercise

instructions are required to deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and 28 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. Eastern Time deadline found in Rule 1100(c).

(h) Modification of cut-off time.

(1) The Exchange may establish extended cut-off times for decision to exercise or not exercise an expiring option and for the submission of Contrary Exercise Advices on a case-by-case basis due to unusual circumstances. For purposes of this subparagraph (h)(1), an "unusual circumstance" includes, but is not limited to, increased market volatility; significant order imbalances; significant volume surges and/or systems capacity constraints; significant spreads between the bid and offer in underlying securities; internal system malfunctions affecting the ability to disseminate or update market quotes and/or deliver orders; or other similar occurrences.

(2) The Exchange with at least one (1) business day prior advance notice, by 12:00 noon on such day, may establish a reduced cut-off time for the decision to exercise or not exercise an expiring option and for the submission of Contrary Exercise Advices on a case-by-case basis due to unusual circumstances; provided, however, that under no circumstances should the exercise cut-off time and the time for submission of a Contrary Exercise Advice be before the close of trading. For purposes of this subparagraph (h)(2), an "unusual circumstance" includes, but is not limited to, a significant news announcement concerning the underlying security of an option contract that is scheduled to be released just after the close on the business day immediately prior to expiration.

[(d)] (i) Submitting or preparing an exercise instruction, Contrary Exercise Advice or Advice Cancel after the applicable exercise cut-off time in any expiring options on the basis of material information released after the cut-off time is activity inconsistent with just and equitable principles of trade.

[(e) For purposes of this Rule with respect to any Member, the word "customer" shall mean every person or organization other than a market maker, broker or the Member itself. The term "exercise instruction," with respect to a market maker, broker and Clearing Member, shall also mean a notice either not to exercise an options position which would otherwise be exercised, or to exercise an options position which would otherwise not be exercised, by operation of the Rules of the Clearing

Corporation, or to modify or withdraw a previously submitted instruction. All exercise instructions must be time stamped at the time they are prepared.]

[(f) No Member may prepare, time stamp or submit an exercise instruction prior to the purchase of the exercised contracts if the Member knew or had reason to know that the contracts had not yet been purchased.]

[(g) Clearing Members must follow the procedures of the Clearing Corporation when exercising expiring noncash-settled equity options contracts. Members must also follow the procedures set forth below with respect to the exercise of noncash-settled equity options contracts which would otherwise not be exercised, or the nonexercise of contracts which otherwise would be exercised, by operation of Clearing Corporation Rule 804:

(1) For all contracts so exercised or not exercised, a "contrary exercise advice," must be delivered by the market maker, broker or clearing firm, as applicable, in such form or manner prescribed by the Exchange no later than 5:30 p.m. Eastern Time.

(2) Subsequent to the delivery of a "contrary exercise advice," should the market maker, broker, customer or firm determine to act other than as reflected on the original advice form, the market maker, broker, or clearing firm, as applicable, must also deliver an "advice cancel," in such form or manner prescribed by the Exchange no later than 5:30 p.m. Eastern Time.

(3) Members shall properly communicate to the Exchange final exercise decisions in respect of positions for which they are responsible.

(4) The preparation, time stamping or submission of a "contrary exercise advice" prior to the purchase of the contracts to be exercised or not exercised shall be deemed a violation of this Rule.

(5) All of the above procedures of this paragraph (g) are in full force and effect whether or not the Clearing Corporation waives the exercise by exception provisions of its Rule 804; in the event of such waiver the procedures of this paragraph shall be followed as if such provisions of Clearing Corporation Rule 804 were in full force and effect. The Clearing Corporation rules may require the submission of an affirmative exercise notice even in circumstances where a contrary exercise advice is not submitted.]

[(6)] (j) The failure of any Member to follow the procedures in this [paragraph (g)] Rule 1100 may result in the assessment of a fine, which may include

but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as determined by the Exchange.

#### Supplemental Material to Rule 1100

.01 For purposes of this Rule 1100, the terms “customer account” and “non-customer account” have the same meaning as defined in the Clearing Corporation By-Laws Article I(C)(28) and Article I(N)(2), respectively.

.02 Each Member shall prepare a memorandum of every exercise instruction received showing the time when such instruction was so received. Such memoranda shall be subject to the requirements of SEC Rule 17a-4(b).

.03 Although the deadline for all option holders to make a final decision to exercise or not exercise is 5:30 p.m. Eastern Time, the deadline for the submission of the Contrary Exercise Advice in the case of non-customer accounts will depend on the manner of the decision to exercise or not exercise.

(i) For electronic time stamp submissions of the exercise decision by non-customer option holders, a Contrary Exercise Advice submitted by Members must be received by the Exchange by 6:30 p.m. Eastern Time.

(ii) For manual submissions of the exercise decision by non-customer option holders, a Contrary Exercise Advice submitted by Members must be received by the Exchange by 5:30 p.m. Eastern Time.

.04 Each Member shall establish fixed procedures to insure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options.

.05 The filing of a Contrary Exercise Advice required by this Rule does not serve to substitute as the effective notice to the Clearing Corporation for the exercise or non-exercise of expiring options.

\* \* \* \* \*

## 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 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 Exchange proposes to simplify the manner in which a CEA is submitted to the Exchange and to extend the cut-off time for submitting CEAs for customer accounts. The Exchange represents that this proposed rule change, as amended, corresponds to an American Stock Exchange LLC (“Amex”) rule change recently approved by the Commission.<sup>6</sup> The ISE is proposing to modify ISE Rule 1100 to mirror the changes to Amex Rule 980.

The Options Clearing Corporation (“OCC”) has an established procedure, pursuant to OCC Rule 805, known as “Exercise-by-Exception” or “Ex-by-Ex” that provides for the automatic exercise of certain options that are in-the-money by a specified amount. Under the Ex-by-Ex process, option holders holding option contracts that are in-the-money by a requisite amount and who wish to have their contracts automatically exercised need to take no further action.<sup>7</sup>

However, under OCC Rule 805, option holders who do not want their options automatically exercised or who want their options to be exercised under different parameters than the Ex-by-Ex procedure must file a CEA with the ISE in accordance with ISE Rule 1100 and instruct OCC of their “contrary intention.”<sup>8</sup> The Exchange states that the rule is designed, in part, to deter individuals from taking improper advantage of late breaking news by requiring evidence of an option holder's intention to exercise or not exercise expiring equity options via the submission of a CEA. Members satisfy the filing requirement by submitting a CEA form directly to the ISE or by electronically submitting the CEA through OCC's electronic communications system.

The Exchange states that one of the primary goals of ISE Rule 1100 is to maintain a level playing field between holders of long and short positions in

expiring equity options. The ISE believes that, after trading has ended on the final trading day before expiration, persons who are short the option have no way to close out their short positions. To put option holders on equal footing, ISE Rule 1100 attempts to minimize the time period in which a holder can exercise an equity option after the close of trading on the last business day prior to expiration.<sup>9</sup>

The current exercise cut-off time for an option holder to decide whether or not to exercise an equity option is 5:30 p.m. Eastern Time (“ET”) on the business day immediately prior to the expiration date.<sup>10</sup> Under the proposed rule change, the exercise cut-off time established in ISE Rule 1100(c) will not change except in cases of a modified trading session or due to “unusual circumstances.” Current ISE Rule 1100 imposes a uniform 5:30 p.m. ET cut-off time for the submission of CEAs for all accounts without differentiation between customer and non-customer accounts.

The Exchange believes that this proposed rule change is necessary to address a concern that the existing deadline for submitting CEAs is problematic for customer accounts due to logistical difficulties in receiving customer exercise instructions and processing them through retail branch systems and back offices before submitting them to the Exchange.<sup>11</sup> Therefore, the Exchange proposes to adopt a cut-off time of 6:30 p.m. ET for Members to submit CEAs for customer accounts. The Exchange also proposes to allow Members to submit CEAs for non-customer accounts by 6:30 p.m. ET provided such Member employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders.<sup>12</sup> In

<sup>9</sup> Expiration, commonly known as “Expiration Friday,” is generally the last business day prior to the expiration of an option contract.

<sup>10</sup> The “expiration date” of an options contract generally is the Saturday immediately following the third Friday of the expiration month of such options. See OCC By-Laws Article I(E)(16). See also Amendment No. 1, *supra* note 3.

<sup>11</sup> A “customer account” is defined in OCC By-Laws Article I(C)(28) as an account of a Clearing Member which is confined to Exchange Transactions cleared and positions carried by the Clearing Member on behalf of its securities customers, other than those transactions of market-makers which are cleared through a market-makers account. OCC By-Laws define a “securities customer” as a person having a securities account at a broker or dealer other than a non-customer of such broker or dealer. See OCC By-Laws Article I(S)(1). See also Amendment No. 1, *supra* note 3.

<sup>12</sup> A “non-customer account” generally means a person that is not a customer of a broker or dealer defined in Rule 8c-1 and 15c2-1 under the Act. See OCC By-Laws Article I(N)(2). See also Amendment No. 1, *supra* note 3.

<sup>6</sup> See Securities Exchange Act Release No. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (SR-Amex-2001-92).

<sup>7</sup> “In-the-money” for a call option occurs if the current market value of the underlying security is above the exercise price of the option. For put options, “in-the-money” means the current value of the underlying security is below the exercise price of the option. See Amendment No. 1, *supra* note 3.

<sup>8</sup> A CEA may be canceled by filing an “Advice Cancel” with the Exchange at any time up to the submission cut-off deadline specified in proposed amended ISE Rule 1100(c). See Amendment No. 1, *supra* note 3.

those cases where Members do not employ an electronic submission procedure for the submission of exercise instructions, CEAs for non-customer accounts must be submitted to the Exchange by 5:30 p.m. ET. The different CEA submission deadlines are set forth in proposed ISE Rule 1100(c) and Supplemental Material .03.

Although most firms have electronic submission procedures, the Exchange is concerned that those firms that manually submit CEAs could have an opportunity to improperly extend the 5:30 p.m. ET deadline for options holders to submit their exercise instructions. This concern on the part of the Exchange is based on the difficulty in monitoring a manual procedure that has different times for deciding whether or not to exercise the option and for the submission of the CEA.

Accordingly, in the case of non-customer accounts, the Exchange proposes to limit the 6:30 p.m. ET deadline for submitting CEAs to those Members that have an electronic submission procedure for option holders to communicate their decisions whether to exercise or not exercise an option. In connection with the use of an electronic submission procedure by Members, the Exchange proposes the addition of new Supplemental Material .04 to ISE Rule 1100 to require Members employing electronic submissions to establish procedures to secure time stamps in connection with their electronic systems.

OCC on occasion will suspend the use of its Ex-by-Ex procedure, such as when trading in the underlying stock has been halted or if accurate price data is unavailable for the determination of closing prices. When this occurs and there is no automatic exercise, all options contract holders must send an exercise notice to OCC if they want to exercise, regardless of whether the option is in or out-of-the-money. Currently, when OCC suspends its Ex-by-Ex procedure for an option class, ISE Rule 1100(g)(5) requires the submission of a CEA. Thus, when OCC has waived the Ex-by-Ex procedure, option holders must determine what price would have been used, even though the only available price might be a stale last sale price (a price OCC did not feel comfortable using). Option holders then must determine whether a CEA needs to be submitted to the Exchange evidencing the intention to exercise or not exercise.

The Exchange proposes to eliminate the requirement that a CEA be submitted if the holder does not want to exercise the option when OCC has waived its Ex-by-Ex procedure for that

options class. As a result, when the Ex-by-Ex procedure has been suspended, submission of CEAs to the Exchange will be required only when the options holder wants to exercise the option contract.

The proposed rule change would also permit the Exchange to establish different cut-off times as an exception to amended ISE Rule 1100(c) to address situations where the Exchange has advance prior knowledge or warning of a modified trading session at expiration, or in the case of "unusual circumstances."

Specifically, proposed ISE Rule 1100(g) would apply when a different or modified close of trading is announced due to a market-wide event. In such cases, the Exchange would have forewarning of the event and would be required to provide notice of a change in cut-off times by 5:30 p.m. ET on the business day prior to the last trading day before expiration. For example, if the day after Thanksgiving is the last trading day prior to expiration with a close of trading of 1 p.m. ET, then the Exchange would, with prior notice by 5:30 ET on the Wednesday before Thanksgiving, be able to establish the cut-off time for option holders to decide whether to exercise or not exercise expiring options to 1 hour 28 minutes after the close of trading. With respect to the submission of CEAs by Members, the cut-off time would be 2 hours and 28 minutes after the close of trading for customer accounts and non-customer accounts where the Member employs an electronic procedure with time stamp for the submission of exercise instructions. Members that do not employ an electronic submission procedure for exercise instructions would be required to submit a CEA within 1 hour and 28 minutes after the close of trading for its non-customer accounts. Accordingly, the normal exercise cut-off time would not apply and, similar to amended ISE Rule 1100(c), the deadline for submitting CEAs to the Exchange for non-customer accounts would depend on the use of an electronic submission procedure for the submission of exercise instructions.

Proposed ISE Rule 1100(h)(1) would permit the Exchange to extend the cut-off time periods for options holders to decide whether to exercise or not exercise expiring options, as well as, for Members to submit CEAs due to unusual circumstances. Situations that may arise that are deemed to be "unusual circumstances" are set forth in proposed ISE Rule 1100(h)(1). An "unusual circumstance" for purposes of proposed paragraph (h)(1) includes, but is not limited to, increased market

volatility; significant order imbalances; significant volume surges and/or systems capacity constraints; significant spreads between the bid and offer in underlying securities; internal system malfunctions affecting the ability to disseminate or update market quotes and/or deliver orders; or other similar occurrences.

Proposed ISE Rule 1100(h)(2) would permit the Exchange, with one (1) business day prior advance notice by 12 noon ET, to establish a cut-off time for option holders to decide whether to exercise or not exercise expiring options as well as for Members to submit CEAs. The reduced cut-off time under this new paragraph for both exercise decisions and CEA submissions may not occur before the close of trading. The primary purpose of this proposed paragraph (h)(2) is to permit the Exchange to reduce cut-off times because of an "unusual circumstance," such as a significant news event occurring after the close. Proposed ISE Rule 1100(h)(2) provides that an "unusual circumstance" is a significant news announcement concerning the underlying security of an option contract that is scheduled to be released after the close on the last trading day prior to expiration. For example, a decision on whether a particular merger will be approved or whether a new product will receive regulatory approval after the close of trading would justify a reduced cut-off time so that persons holding short positions are not prejudiced by being unable to close out their positions. The Exchange believes that this would maintain a level playing field between persons holding long and short positions in expiring options.

## 2. Statutory Basis

The Exchange believes that its proposed rule change, as amended, is consistent with section 6(b) of the Act in general<sup>13</sup> and furthers the objectives of section 6(b)(5) in particular,<sup>14</sup> because it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The Exchange believes that the proposed rule change, as amended, does

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

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, as amended. 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**

The proposed rule change, as amended, has been filed by the Exchange pursuant to section 19(b)(3)(A) of the Act<sup>15</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>16</sup> Because the foregoing proposed rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for thirty days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to section 19(b)(3)(A) of the Act<sup>17</sup> and Rule 19b-4(f)(6)<sup>18</sup> thereunder.<sup>19</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>20</sup> normally does not become operative prior to thirty days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii), the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The ISE has requested that the Commission accelerate the implementation of the proposed rule change to take effect prior to the thirty days specified in Rule 19b-4(f)(6)(iii)<sup>21</sup> so that members will be subject to uniform CEA rules among the options exchanges.

The Commission believes that waiving the thirty-day operative date is consistent with the protection of

investors and the public interest.<sup>22</sup> Accelerating the operative date will allow the ISE to immediately implement rules similar to ones already in place at the Amex,<sup>23</sup> and will simplify and clarify the process by which Members accept exercise decisions from options holders and submit such decisions to the Exchange. For these reasons, the Commission designates the proposed rule change as effective and operative immediately. At any time within 60 days of the filing of the proposed rule change, as amended, the Commission may summarily abrogate such proposed rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>24</sup>

**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. 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 ISE. All submissions should refer to File No. SR-ISE-2003-20 and should be submitted by October 17, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>25</sup>

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

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-48514; File No. ISE-2003-21]

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the International Securities Exchange, Inc. Relating to the Extension of the Pilot Program for Quotation Spreads**

September 22, 2003.

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 September 22, 2003, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the ISE. The proposed rule change has been filed by the ISE under Rule 19b-4(f)(6) of the Act.<sup>3</sup> 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 extend until January 31, 2004, a pilot program permitting the allowable quotation spread for options on up to 50 equity securities to be \$5, regardless of the price of the bid ("Pilot Program"). The ISE proposes no substantive changes to the Pilot Program other than extending its operation through January 31, 2004. Pursuant to Rule 19b-4(f)(6) under the Act, the ISE requests that the Commission waive the 30-day pre-operative requirement contained in Rule 19b-4(f)(6)(iii).<sup>4</sup>

**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

<sup>15</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>16</sup> 17 CFR 240.19b-4(f)(6).

<sup>17</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>18</sup> 17 CFR 240.19b-4(f)(6).

<sup>19</sup> As required under Rule 19b-4(f)(6)(iii), the Exchange provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing date or such shorter period as designated by the Commission.

<sup>20</sup> 17 CFR 240.19b-4(f)(6).

<sup>21</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>22</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>23</sup> See *supra* note .

<sup>24</sup> For purposes of calculating the sixty-day abrogation period, the Commission considers the period to commence on September 9, 2003, the date at which the Exchange filed Amendment No. 1.

<sup>25</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

<sup>4</sup> 17 CFR 240.19b-4(f)(6)(iii).