

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50193; File No. SR-BSE-2004-35]

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Eliminate the Requirement That Certain Market Makers on the Boston Options Exchange Facility With No Public Accounts and Who Do Not Solicit Public Accounts, Maintain Certain Information Barriers

August 13, 2004.

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 August 12, 2004, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") 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 BSE. The Exchange filed this proposal pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission.⁵ 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 BSE proposes to eliminate the Information Barrier requirement set forth in the Boston Options Exchange Facility ("BOX") Rules Chapter VI, Section 10 in the limited circumstances where a Market Maker, which also functions as an Order Flow Provider,⁶ engages solely in proprietary trading and does not, under any circumstance, maintain customer accounts or solicit or accept orders from or on behalf of public customers. The text of the proposed rule change is below. Proposed additions are in italics.

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Chapter VI Market Makers

Sec. 10 Limitations on Dealings

(a) General Rule. A Market Maker on BOX may engage in Other Business Activities, or it may be affiliated with a broker-dealer that engages in Other Business Activities, only if there is an Information Barrier between the market making activities and the Other Business Activities. "Other Business Activities" means:

- i. Conducting an investment banking or public securities business;
- ii. Making markets in the stocks underlying the options in which it makes markets; or
- iii. Functioning as an Order Flow Provider, *except where such Market Maker, or a broker-dealer with which such Market Maker is affiliated: (A) engages solely in proprietary trading and does not, under any circumstance, maintain customer accounts or solicit or accept orders or funds from or on behalf of public customers, including broker-dealers and other securities firms, and (B) does not place or accept directed orders or utilize any other order types which call for the participation of, or interaction with, public customers, including broker-dealers and other securities firms.*

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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 BSE 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 Information Barrier requirements set forth in Chapter VI, Section 10 of the BOX Rules, provide critical safeguards to prevent the use or communication of material non-public information by market making firms (and affiliated broker-dealers) to inappropriately benefit other business activities in which they may engage, such as investment banking or equities market making. Such information could relate to, for example, the Market Maker's

customer and directed order flow or other information obtained by the Market Maker in the course of its business. Such barriers help to ensure that market making firms do not illegally take advantage of or communicate such information to benefit their other business activities, to the detriment of investors, customers, issuers and the integrity of the market.

For business reasons, certain registered Market Makers, or broker-dealers with which such Market Makers are affiliated, engage solely in proprietary trading. Accordingly, such firms do not maintain public customer accounts or solicit or accept orders or funds (and hence, would not accept directed order flow) from or on behalf of public customers, including broker-dealers and other securities firms. Under such circumstances, because the market making firm does not engage in any other business activities that may benefit from information obtained by the Market Maker in the course of the firm's market making activities, the Exchange believes that the concerns noted above which form the basis for the Information Barrier requirements set forth in Chapter VI, Section 10 of the BOX Rules do not apply.⁷ Nevertheless, Chapter VI, Section 10 of the BOX Rules would require such a firm to develop and implement Information Barriers.

Under such circumstances, the Exchange believes that an Information Barrier requirement is unnecessary and would impose an undue burden on the market making firm. Accordingly, this proposed rule change eliminates this requirement in the limited circumstances where a market making firm and its affiliated broker-dealer do not maintain public customer accounts, nor solicit or accept public customer orders, including from broker-dealers and other securities firms (and does not accept directed order flow or utilize any order type which presupposes the participation of public customers), and engage solely in proprietary trading. The Exchange believes that this limited modification is consistent with the purposes of the rule. However, if the market making firm or its affiliated broker-dealer subsequently decides to maintain public customer accounts or solicit public customer accounts (and directed order flow or order types which presuppose the participation of public customers), then the requirements of Chapter VI, Section 10 of the BOX Rules would apply. Further, this limited

⁷ The proposed rule change is designed to accommodate the needs of these Market Makers. The current rule did not foresee the business conditions that currently exist which necessitate this change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ The BSE provided the Commission with notice of its intention to file the proposed rule change on July 6, 2004. See Rule 19b-4(f)(6)(iii). 17 CFR 240.19b-4(f)(6)(iii).

⁶ See Chapter I, Section 1(a)(46) of the BOX Rules (definition of "Order Flow Provider").

modification would not alter or adjust any other obligation imposed on Market Makers, including those set forth in Chapter VI, Section 5 of the BOX Rules (Obligations of Market Makers).

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6(b) of the Act,⁸ in general, and Section 6(b)(5) of the Act,⁹ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.

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

The BSE does not believe that the proposed rule change will 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 neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) Impose any significant burden on competition; and
- (iii) Become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and Rule 19b-4(f)(6) thereunder.¹¹ At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such 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.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule

change 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 Number SR-BSE-2004-35 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-BSE-2004-35. 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 Section, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of such filing also will be available for inspection and copying at the principal office of the BSE. 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-BSE-2004-35 and should be submitted on or before September 10, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50197; File No. SR-ISE-2004-18]

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendments No. 1 and 2 Thereto To Amend the Market Maker Information Barrier Requirements Under ISE Rule 810

August 13, 2004.

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 May 26, 2004, the International Securities Exchange, Inc. ("ISE" or "Exchange") 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 Exchange. The Exchange amended the proposal on August 6, 2004,³ and August 13, 2004.⁴ 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 Exchange proposes to replace the defined term "Chinese Wall" with the defined term, "Information Barrier" in ISE Rule 810. The Exchange also proposes to amend ISE Rule 810 to eliminate the requirement that a market maker maintain an Information Barrier in the limited circumstances where (i) a market maker, or broker-dealer affiliated with such market maker, engages solely in proprietary trading and does not, under any circumstances, maintain customer accounts or solicit orders or funds from or on behalf of Public Customers⁵ or broker-dealers; and (ii) the sole extent to which such market maker, or broker-dealer affiliated with such market maker, handles listed options orders as agent on behalf of Public Customers or broker-dealers consists of handling such orders

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On August 6, 2004, the Exchange filed a Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1").

⁴ On August 13, 2004, the Exchange filed a Form 19b-4, which replaced the original filing and Amendment No. 1 in their entirety ("Amendment No. 2").

⁵ ISE Rule 100(a)(32) defines "Public Customer" as "a person that is not a broker-dealer in securities." ISE Rule 100(a)(33) defines "Public Customer Order" as "an order for the account of a Public Customer."

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

¹² 17 CFR 200.30-3(a)(12).