

Regulatory Information Circular			
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The ISE's proposed rule change to require market maker quotes to be firm for the same size for all orders, and system enhancements to implement this change, will be effective for trading on Wednesday, January 22, 2003. The rule and system changes are as follows:

- Market makers may specify only two different quotation sizes.

Order Execution Size: The size that is good for all order types, including public customer, non-customer, FARMM and other ISE market makers.

Quotation Execution Size: The size that will be executed when two ISE market maker quotes cross internally.

- Derived orders will be firm for all order types.
- FARMM orders will no longer lock upon entry.

The ISE's proposed repeal of Rule 717(h) will also be effective on January 22nd. This rule prohibited members from entering more than one order every 15 seconds for the same beneficial account. Rule 717(f), which prohibits the electronic generation of orders, remains in effect and applies to market maker orders entered in options other than those to which they are appointed (i.e., options outside their market maker bins).

The text of the rule changes is attached.

Underlining indicates additions; [brackets] indicate deletions

Rule 717. Limitations on Orders

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[(h) Multiple Orders for the Same Beneficial Account.

Member shall not cause the entry of more than one order every fifteen (15) seconds, for the account of the same beneficial owner in options on the same underlying security; provided, however that this shall not apply to multiple orders in different series of options on the same underlying security if such orders are part of a spread.]

Rule 804. Market Maker Quotations

(a) *Options Classes.* A quotation only may be entered by a market maker, and only in the options classes to which the market maker is appointed under Rule 802.

(b) *Size Associated with Quotes.* A market maker's bid and offer for a series of options contracts shall be accompanied by the number of contracts at that price the market maker is willing to buy [from] or sell (i) upon receipt of an order ("Order Execution Size") and (ii) upon interaction with a quotation entered by another market maker on the Exchange ("Quotation Execution Size") [to (i) Public Customers (the "Public Customer Size") and (ii) Non-Customers (the "Non-Customer Size")]. Unless the Exchange has declared a fast market pursuant to Rule 704, a market maker may not initially enter an Order Execution Size [a bid or offer with a Public Customer] of less than ten (10) contracts. Where the size associated with a market maker's bid or offer falls below ten (10) contracts due to executions at that price and consequently the size of the best bid or offer on the Exchange would be for less than ten (10) contracts, the market maker shall enter a new bid or offer for at least ten (10) contracts, either at the same or a different price. Every market maker bid or offer must have a Quotation Execution [a Non-Customer] Size of at least one (1) contract.

(c) *Two-Sided Quotes.* A market maker that enters a bid (offer) on the Exchange must enter an offer (bid) within the spread allowable under Rule 803(b)(4).

(d) *Firm Quotes.* (1) Market maker bids and offers are firm for orders and Exchange market maker quotations [Public Customer Orders and Non-Customer Orders] both under this Rule and Rule 11Ac1-1 under the Exchange Act ("Rule 11Ac1-1") for the number of contracts specified [for each] according to the requirements of paragraph (b) above. Market maker bids and offers are not firm under this Rule and Rule 11Ac1-1 if:

(i) a system malfunction or other circumstance impairs the Exchange's ability to disseminate or update market quotes in a timely and accurate manner;

(ii) the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing, and making available to quotation vendors the data for the option in a manner that accurately reflects the current state of the market on the Exchange, and as a result, the market in the option is declared to be "fast" pursuant to Rule 704;

(iii) during trading rotations; or

(iv) any of the circumstances provided in paragraph (c)(3) of Rule 11Ac1-1 exist.

(2) Within thirty seconds of receipt of an order [a Public Customer Order (Non-Customer Order)] to buy or sell an option in an amount greater than the Order Execution Size, or within thirty seconds of another Exchange market maker entering a quotation at a price executable against the market maker's quotation [Public Customer Size (Non-Customer Size)], that portion of the order equal to the Order Execution Size, or the Quotation Execution Size, as the case may be. [Public Customer Size (Non-Customer Size)] will be executed and the bid or offer price will be revised.

[Supplementary Material to Rule 804

.01 Notwithstanding the provisions of paragraph (b), for the "Enhanced Size Pilot" described in .02 below, a Primary Market Maker may not initially enter a bid or offer for a Public Customer of less than 100 contracts, and a bid or offer for Non-Customers (except for other market makers) of less than 50 contracts. Also for the purposes of the Enhanced Size Pilot, a Competitive Market Maker may not initially enter a bid or offer for a Public Customer of less than 50 contracts, and a bid or offer for Non-Customers (except for other market makers) of less than 25 contracts. Where the size associated with a market maker's bid or offer falls below such specified size, the market maker shall enter a new bid or offer for at least the specified size, either at the same or a different price.

.02 The Enhanced Size Pilot shall operate as follows:

(1) The Enhanced Size Pilot shall operate until October 31, 2002;

(2) Securities included in the Enhanced Size Pilot are options on: Nasdaq 100 Trust; Sun Microsystems; EMC Corp.; Qualcomm; Wells Fargo & Co.; Oracle; Lucent; Juniper Networks; Intel; AOL Time Warner; Tyco; Citigroup; Cisco; Applied Materials; Microsoft; General Electric; Broadcom; Nokia; Siebel Systems; Banc of America; Ciena; Dell; Fannie Mae; Motorola; Merrill Lynch; Nvidia; Xilinx; Amazon.com; Halliburton; Nextel Communications; J.P. Morgan Chase; ADC Telecommunication; Best Buy; Calpine; General Motors; and Hewlett Packard; and

(3) The size requirements in the Enhanced Size Pilot will not apply:

- (a) To options that expire beyond the nearest three expiration months;
- (b) To "Deep-in-the-Money" options; or
- (c) On an option's last three trading days prior to expiration.

03. For the purpose of this Rule, "Deep-in-the-Money" means all options with strike prices that are in the money by 12 percent or more in relation to the at-the-money strike price.]

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Rule 805. Market Maker Orders

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[(c) Exemptive Authority. Until the earlier of (1) one year from the date on which the Exchange commences operations or (2) the date on which the Exchange opens all options Groups for trading, an Exchange official designated by the Board may grant market makers exemptions from the requirements of subparagraphs (b)(2) and (3) of this rule, subject to the following:

(1) If a market maker has only one Membership, and thus is assigned to only one Group, any exemption would end when the assigned Group is open for trading, regardless of the number of options classes that begin trading in the assigned Group;

(2) If a market maker has multiple Memberships, and thus is assigned to trading in more than one Group, the exemption would end when all the market maker's Groups are open

for trading, again regardless of the number of options classes that begin trading in the assigned Groups; as the market maker's assigned Groups open for trading, the amount of trading the market maker would be permitted to execute outside of its assigned Groups would be reduced;

(3) Any exemption would be conditioned on the member performing market maker functions in the classes they trade;

(4) An exemption could be revoked by the Exchange at any time if the market maker is not acting in accordance with the terms of the exemption; and

(5) No exemption would have a term of more than one month, but would be renewable on a monthly basis until the market maker's group(s) was open for trading.]