INTERNATIONAL SECURITIES EXCHANGE.

Regulatory Information Circular			
Circular number:	2003-06	**Contact**:	Jim Sampson, VP Market Supervision
Date:	April 21, 2003	**Telephone**:	212/897-0235

Subject: Phase 2 of Linkage

Phase 2 of the SEC mandated linkage plan will commence on April 25, 2003. This document will outline the major changes associated with Phase 2.

- **Order Size and Handling**

In Phase 2, ISE market makers may send outbound Principal ("P") and Principal/Agent ("P/A") Orders larger than current limitation on the size of linkage orders (that is, the auto-execution size).

P/A Orders – A PMM may send a P/A Order, at a price equal to the NBBO, up to the size of the underlying customer order. If the P/A Order is larger than the Firm Customer Quote Size (as defined in Rule 1900), the PMM has two options:

> The PMM may send a P/A Order representing the entire customer order. The receiving exchange may handle all or part of this order manually, and must inform the PMM of the P/A Order's fill and cancel quantities within 15 seconds of receipt of the order.
>
> Alternatively, the PMM may send an order in the amount of the Firm Customer Quote Size for an automatic execution. If the receiving exchange does not denigrate its quote within 15 seconds, the PMM may send a second P/A Order in amount of the lesser of 100 contracts or the balance of the original order. If the receiving exchange does not execute a P/A Order in full, that exchange must move its quote to a price inferior to the original P/A Order's price.

P Orders – A market maker may send a P Order for any size at a price equal to the NBBO. For P Orders of a size up to the Firm Principal Quote Size (currently set at 10 contracts for all exchanges), the sending exchange is due an automatic execution. For P Orders larger than 10 contracts, the receiving exchange may execute all or part of the order manually, and must execute the order for at least 10 contracts. Within 15 seconds of receipt of such order, the receiving exchange must send the PMM the P Order's fill and cancel quantities. If the receiving exchange does not execute the P Order in full, it must move its quote to a price inferior to the original P Order's price.

- **Satisfaction Orders**

Phase 2 sees the introduction of Satisfaction Orders. These are orders an exchange uses to access an away market when a member of another exchange has traded through customer order(s) on an exchange's book included within that exchange's disseminated quotation. With respect to an ISE Member trading through another exchange, the liability for that trade-through falls upon the Member who initiated the trade through. This could be an EAM who enters an order on behalf of a customer who has elected to "ignore away market," an EAM who enters a firm, Broker/Dealer, or FARMM order when there exists a better market away, or a PMM who releases an order into the ISE market while there exists a better market away.

Certain exemptions from trade-through liability apply. See ISE Rule 1902. The ISE will investigate each Satisfaction Order it receives to determine whether the order is valid, and, if so, the Member responsible for filling the order.

- **Regulatory Obligations**

With Phase 2, a pattern or practice of trading through the NBBO will be a violation of ISE rules. This applies even if the ISE does not receive a Satisfaction Order from an away market. Please review paragraphs (b) and (d) of ISE Rule 1902 for a further explanation of this rule and the applicable exemptions.

* * *

The ISE has developed a linkage tutorial that provides a high-level overview of how linkage operates. While geared primarily toward the EAM community, those interested in obtaining additional information may find it beneficial. The tutorial is available for your viewing at http://www.iseoptions.com/linkage.asp.

Please contact me with any questions.