To: ISE Members  
Date: November 1, 2002  
Re: Filing of Rule Change to Adopt Single Volume Level of ISE Quotes  

The Securities and Exchange Commission has published for comment an ISE proposed rule change to establish a single volume level for all ISE quotations. (Securities Exchange Act Release No. 34-46723) The text of the proposed rule change is attached. The specifics of the proposal are as follows:

- Each ISE Primary Market Maker and Competitive Market Maker will enter a quotation with a single volume level for all incoming orders. Thus, the full size of the ISE's disseminated quotations will be available for orders from customers, broker-dealers, ISE market makers and FARMMs. The FARMM lock will be discontinued.

- Each ISE market maker will be able to establish a second quotation size that will be available when its quotation interacts with another ISE market maker quotation.

- Currently, ISE's rules provide that Electronic Access Members may not enter more than one order every 15 seconds for the account of the same beneficial owner in the same underlying security. This restriction will be extended to orders of ISE market makers. As with EAM orders, this will not apply to spreads or other complex orders.

These changes will become effective upon approval by the SEC and the implementation of necessary system changes. We currently anticipate that this will occur by January 2003. The ISE will give notice prior to the implementation of these changes.

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Questions regarding this circular may be directed to Jim Sampson, Vice President Market Supervision, at 212/897-0235.
Text of Proposed Rule Change

Underlining indicates additions; [brackets] indicate deletions

**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.

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Rule 805.  Market Maker Orders

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(c) Limitations on Orders. A market maker shall not enter more than one order every fifteen (15) seconds for its own account 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.

[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.]