INTERNATIONAL SECURITIES EXCHANGE.

Market Information Circular			
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New Proposed Functionality

The ISE has filed a proposed "Price Improvement Mechanism" with the SEC. We plan to implement this functionality as soon as practical after the SEC approves this filing.

At this time, while certain details may change, ISE believes it is appropriate to share with the membership two trading features that are currently in development and being tested in-house.

1. The ability to submit orders to the Price Improvement Mechanism (PIM).
2. The ability to direct orders to market makers.

As we receive feedback from the SEC regarding these functions, we will maintain continuous contact with the membership to provide as much lead-time as possible prior to implementation. At this time we have no indication as to when SEC action may be forthcoming.

Price Improvement Mechanism

Members can submit customer orders to the Price Improvement Mechanism (PIM) where the member commits to trade with the full quantity of the order, at a price that improves upon the NBBO by at least one cent.

The order is exposed for three seconds. During the exposure period, market makers can improve upon the execution price in one-cent increments to the benefit of the customer. An EAM having a Customer PIM Order (CPO) on the book at the NBBO may also respond on behalf of its customer in one-cent increments. All members can respond in standard increments by placing orders in the book. Members are informed of each response to a PIM and may further improve upon their own responses.

At the end of the three-second exposure period, the order is traded with all responses and the order book in price priority. The submitting member will get a 40% share at its price. Customer orders are executed in time priority then non-customer orders receive a pro-rata share. Once the PIM is started, the order cannot be cancelled or altered.

Processing Directed Orders

Customer Orders may be directed to a specific market maker. If the market maker is at the NBBO at the time the order is entered, a snapshot of the market maker's quote is taken, called the Guaranteed Directed Order (GDO).

The market maker can submit the order to the PIM for guaranteed price improvement.

Alternatively, the market maker can release the order to trade against the book. If the market maker's quote should fade prior to the release of the order, the GDO is executed instead of the quote.

All order types except STOP orders and COMPLEX orders may be directed to a market maker.

Members that connect via the CLICK or a FIX connection can specify the acronym of the market maker on each order. Members that connect with the Standard Order Format can arrange to have their orders directed to a specific market maker.

Directed Orders – Market Maker Functionality

When an EAM directs an order to a specified market maker, the order is stored in the exchange system. A lock message is sent to the market maker with the details of the order in the same manner as an away market lock. The order will have a status of *directed lock*. The quantity, price and side of the order are disclosed.

At the time that the directed order is entered, the exchange system checks the market maker's quote. If the quote is at the NBBO, the exchange system will take a snapshot of the quote and save it as the Guaranteed Directed Order or GDO. The GDO is saved for later use by that specific directed order.

The market maker has two alternatives to process the order:

1. The order can be submitted to a PIM for guaranteed price Improvement. The market maker commits to trade with the full quantity of the order at a price that improves upon the NBBO by at least one cent. The market maker will receive priority on 40% of the order at its price.

   Submitting an order to the PIM is accomplished in a manner similar to the existing *trade-report* function. When the Directed Lock is received, a *Convert To Special* function is entered which contains the market maker counterparty information and references the locked order. The price must improve upon the NBBO and can be in one-cent increments.

2. Alternatively, the market maker can release the order to trade against the book using the same function as releasing an *away-market* lock.

   When the order is released, the system checks the market maker's quote. If the quote is at the NBBO, or was at the NBBO at the time the order was entered, the order will first trade out all orders and quotes at the NBBO, except the market maker's quote or its GDO. The order is then exposed to the market for three seconds. After the exposure period, the order will trade in price priority. At each price level, customers are traded first, then non-customers, and the market maker is traded last.

   If the market maker's quote is not at the NBBO, and was not at the NBBO at the time of entry, the order is processed in the normal manner.

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