

<b>Market Operations Information Circular</b>			
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### **Subject: Linkage – “Trade Book and Ship” rule adoption**

The ISE has adopted new so-called “Trade Book and Ship” rules which affect the manner in which orders may be handled in Linkage. The purpose of this circular is to inform you of the changes and to illustrate them through examples.

#### **Trade Book and Ship**

The ISE recently received SEC approval to add a “Trade and Ship” exception to the definition of “Trade-Through” and add a “Book and Ship” exception to the provision relating to locked markets respectively. Accordingly, an ISE Primary Market Maker (“PMM”) may now trade an order at a price that is one minimum quoting increment inferior to the national best bid or offer (“NBBO”) if a Linkage Order is sent contemporaneously to the market(s) disseminating the NBBO to satisfy all interest at the NBBO price.<sup>1</sup>

The rule change also provides that an ISE market maker may enter an order on the ISE that would otherwise lock another market if a Linkage Order is sent contemporaneously to such other market to satisfy all interest at the lock price and only the remaining portion of the order is booked. Under this rule, any execution received from the market disseminating the NBBO must be reassigned to the customer order that is underlying the Linkage Order that was sent to trade with the market disseminating the NBBO.

To illustrate:

#### **Example 1**

*Trade and Ship - Only one market is at the NBBO*

ISE market: 2.40 - 2.80 (200 X 200)  
 Away Mkt 1: 2.40 - 2.75 (10 x 10)  
 NBBO: 2.40 - 2.75

1. ISE receives an order to buy 100 @ 2.80.
2. Order locks with the away market better lock.
3. The PMM sends a Linkage Order for 10 contracts to Away Mkt 1.

<sup>1</sup> The minimum quoting intervals are currently .05 for quoted two-sided markets with bids below \$3.00, and .10 for quoted two-sided markets with bids at or above \$3.00.

4. PMM immediately releases the balance to trade on the ISE @ 2.80.

This complies with the requirement to send away orders to the full extent of the NBBO size and then to trade at 1 tick worse than the NBBO.

### **Example 2**

*Trade and Ship - Two markets at the NBBO*

ISE market: 2.40 - 2.80  
Away Mkt 1: 2.40 - 2.75 (10 x 10)  
Away Mkt 2: 2.40 - 2.75 (10 x 10)  
NBBO: 2.40 - 2.75

1. ISE receives an order to buy 100 @ 2.80.
2. Order locks with the Away Market Better lock.
3. The PMM sends a 10 contract Linkage Order to both Away Mkt 1 and Away Mkt 2. The PMM may then release the balance to the ISE.

The PMM must simultaneously ship orders to the full extent of the NBBO (20) and release the balance to trade on the ISE at one tick below the NBBO.

### **Example 3**

*Trade and Ship - Two markets better than the ISE but only one at the NBBO*

ISE market: 2.40 - 2.85  
Away Mkt 1: 2.40 - 2.75  
Away Mkt 2: 2.40 - 2.70  
NBBO: 2.40 - 2.70

1. ISE receives an order to buy @ 2.85.
2. Order locks with the Away Market Better lock.
3. PMM sends Linkage Orders to Away Mkt 2 and/or Away Mkt 1.

The PMM must attempt to clear all interest that is superior to the ISE market. Therefore, the PMM should send a Linkage Order to Away Mkt 2 first, followed by a Linkage Order to Away Mkt 1 for any remaining balance. This must be performed before trading on the ISE. The PMM must handle this sequentially by executing the NBBO on Away Mkt 2, waiting for the market to decrement, then either sending a second Linkage Order to Away Mkt 2 and/or Away Mkt 1 if it has then becomes the NBBO. Note that the PMM may not contemporaneously trade or release at the ISE market as the ISE is not within 1 tick of the NBBO.

### **Example 4**

*Trade and Book - After sending an order to the away market, releasing the balance to the ISE book results in a locked market.*

ISE market: 2.40 - 2.80 (50 x 50)  
Away Mkt 1: 2.35 - 2.75 (10 x 10)  
NBBO: 2.40 - 2.75

1. ISE receives an order to buy 100 @ 2.80.
2. PMM sends a Linkage Order to Away Mkt 1 to the extent of the quoted size @ 2.75 (10)
3. The PMM releases the balance of the order (90) to the ISE market. After trading the ISE offer at 2.80, ISE market becomes 2.80 - 2.90 (90 x 10). Away Mkt 1 fades its 2.75 offer after executing ISE order thus becoming 2.35 - 2.80. The release of the order to the ISE order book results in a locked market. Note that any resulting lock becomes the responsibility of the entering firm to address.

The functionality required to facilitate this processing will be made available by the ISE in its "R6" software release currently scheduled for deliver in early February 2006.

These examples are only provided to illustrate several of the many possible scenarios. Please contact Wendy Hoffman at 212/897-0245 or me with any questions.