

Regulatory Information Circular – 2001-09

To: ISE Market Makers

Date: May 1, 2001

Re: Trading Ahead of Block Order Intentions

An Electronic Access Member (“EAM”) may enter large-size orders into the Block Order Mechanism to solicit additional liquidity for their customer orders.¹ Upon entry of such an order, a message is broadcast to the ISE “crowd,” consisting of all market makers assigned to the options class and all other members with proprietary orders at the inside bid or offer in that series. The Block Mechanism gives crowd members 30 seconds to respond to the broadcast.

A market maker, upon receipt of a Block Order Mechanism broadcast specifying that a block order is pending, and identifying that the order is either to buy or to sell, may not trade ahead of that order by entering an order that trades against the available liquidity being displayed in the market.² Such activity is considered a violation of just and equitable principles of trade (ISE Rule 400) and may subject the member to disciplinary action. There will be a presumption that market makers have knowledge of pending block orders in their assigned options classes. Additionally, in these circumstances, an EAM receiving a block broadcast may not enter orders that trade against the available liquidity for the benefit of the firm’s proprietary account.

For example, with an option market bid 3.20 and offered 3.40, an EAM enters a Block Order to sell 500 contracts at 3.20 and the crowd receives a Block Order Mechanism broadcast indicating a pending sell order. If, during the 30-second block response period, an ISE market maker in that bin were to enter an order to sell any number of contracts at 3.20, there will be a presumption that the market maker had knowledge of the order and traded ahead of the order in violation of ISE Rule 400.

For further information on trading ahead of block orders, or if you have any questions, please contact Jim Sampson, Director of Market Surveillance and Regulation at 212/897-0235.

¹ Pending before the Securities and Exchange Commission is a rule proposal that would permit market makers to enter orders into the Block Order Mechanism.

² A Block Order Mechanism broadcast need not specify whether the pending order is to buy or sell a block. If a message does not indicate the side of the market in which the block is pending, there are no restrictions on “trading ahead” of that block.