

# **International Securities Exchange**

**Introduction**



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The International Securities Exchange (“ISE”), the first all electronic options exchange in the United States, began trading on May 26,2000. This information kit will help you prepare for participating in this exciting new market.

The kit contains the following material:

- Background information on the ISE
- Details of the market from a market maker and broker/dealer perspective
- Background information for technical staff regarding the central exchange system, trader workstations and network architecture
- Membership application form

If you plan to send agency or proprietary orders to the Exchange, while you will not need to purchase a “seat,” you will need to register with the ISE as an Electronic Access Member (“EAM”) and obtain membership approval.

If you plan to become a market maker at the ISE, you will first need to contact Adirondack Trading Partners (“ATP”) and arrange for the purchase or lease of an Exchange membership (see contact details at the end of this document). You must then register with the ISE and obtain membership approval.

Following equipment installation, the ISE will conduct several training sessions and market simulations. Each trader in a market maker firm is required to pass a Designated Trading Representative (“DTR”) exam. The ISE will provide system training and all necessary manuals.

Initially, the ISE listed a select number of stock options. Eventually, the ISE will list 600 of the most actively traded stock options, which represent 90% of the average daily trading volume in the options industry.

## **Background**

The formation of the first fully electronic U.S. options exchange, the International Securities Exchange, was announced in November 1998. While most non-U.S. options exchanges are electronic, the four existing U.S. options exchanges maintain floor-based systems of trading.

The ISE is the first exchange of its type, as it combines electronic trading with auction market principles. The ISE offers options trading on the most actively traded options classes. Trading on the new automated market provides members with several benefits, including significantly reduced costs, rapid and accurate order executions and a mechanism to protect customer orders from automatically trading at prices inferior to those available on other options markets. Two unique features of the ISE system are: the total size associated with the best bid and offer is shown, and firms entering orders and quotes retain complete anonymity.

The ISE became a registered exchange with the Securities and Exchange Commission ("SEC") on February 24, 2000. As a fully registered securities exchange, the ISE is a self-regulatory organization ("SRO") with a surveillance department and systems that monitor all trading functions to ensure compliance with ISE and SEC rules.

The ISE was funded by a consortium of broker/dealers, which provided the capital necessary to develop the trading and regulatory systems, acquire hardware, and accomplish all other endeavors associated with establishing the Exchange.

The ISE uses an advanced version of the OM CLICK Exchange® system, supplied by OM Technology, which is a subsidiary of OM Gruppen AB. OM Gruppen AB is a public company which operates OM-SE (the Sweden derivatives exchange), SSE (the Stockholm Stock Exchange) and OM-LX (the combined Sweden-London derivatives exchange). OM Technology already supplies the OM CLICK Exchange® system to many international derivatives exchanges and the U.S. based California Power Exchange, CAL-PX.

The ISE's system runs on Compaq's latest generation 64-bit Alpha EV6 processors. Market makers can use Torque trading stations based on OM Technology's NxOrc trading station, a state of the art tool for pricing and trading financial instruments in real time. Members may also develop their own proprietary systems or purchase applications from third party suppliers.

## **Benefits**

The opening of the ISE has resulted in fundamental changes in options trading in the United States. The ISE's market is designed to accomplish the following goals:

- Improve the current levels of turnover and liquidity
- Provide a fair market with equal access for all participants
- Provide firm markets, allowing customers to trade at the prices and sizes that are displayed in the market
- Provide a structure that fosters market maker competition through independent quoting, which is essential for promoting liquidity
- Provide clear and unambiguous trading rules with accurate audit trails and regulatory supervision of the market

## **Exchange Structure and Membership**

The ISE plans to list and trade 600 stock options, which are divided into ten groups of approximately 60 stock options each. Market makers are assigned to provide liquidity in each group.

There are three types of ISE members:

- **Electronic Access Member (“EAM”)** – EAMs are broker/dealers that represent agency and proprietary orders on the Exchange. An EAM does not purchase a membership. Rather, once approved as an ISE member, an EAM pays an access fee that permits the firm to place orders in all of the options traded on the Exchange. EAMs cannot enter quotations or otherwise engage in market making on the Exchange.
- **Primary Market Maker (“PMM”)** - PMMs, similar to specialists (DPMs or LMMs), are market makers with significant responsibilities, including overseeing the opening, providing continuous quotations in all of their assigned options classes, and ensuring that customer orders are not executed at prices inferior to those available at other options exchanges. A PMM must purchase or lease a PMM membership entitling the member to act as PMM in one group of stock options. One PMM is assigned to each of the ten groups of options traded on the Exchange.

An important advantage of having a PMM assigned to each stock option is that members have a point of contact, who is responsible for maintaining orderly markets and is available to answer market questions and resolve trading related issues.

- **Competitive Market Maker (“CMM”)** - CMMs are market makers that add depth and liquidity to the market and are required to provide continuous quotations in a significant portion of the options classes in their assigned group. Each CMM quotes independently. A CMM must purchase or lease a CMM membership, and each membership entitles the member to enter quotations in one group of options. Up to ten CMMs are appointed to each of the ten groups of stock options traded on the Exchange.

An organization may obtain more than one membership. It is possible to be a PMM in one group of options, obtain several CMM memberships to provide markets in other groups, and have an EAM membership to enter agency and proprietary orders in all groups. Firms that are both market makers and EAMs must conduct those activities separately. A member may not be both a PMM and CMM in the same group of options. Market makers are not permitted to represent agency orders.

The ISE is a member of the Options Price Reporting Authority (“OPRA”) and an owner-participant of The Options Clearing Corporation (“OCC”). The ISE’s quotes and trades are provided to OPRA, and trades are cleared by OCC. Options contracts traded on the ISE are fungible with contracts traded on other U.S. options exchanges.

## **Trading Improvements**

The ISE’s market delivers the following benefits and functions to its members (greater detail on each of these functions is contained in the accompanying brochures):

### ➤ **Order Management**

Members have direct access to the system, which allows for the immediate entry, amendment and cancellation of orders in the central orderbook.

### ➤ **Anonymity**

The ISE offers completely anonymous trading. Members that enter orders or quotes are identified in the ISE system, but this information is not visible to any ISE participants. Even the PMM, who can view the full orderbook, is not given member identity information. When executions occur, the parties involved in the execution are informed that they have traded; however, they are not advised of the identity of the counter-party.

### ➤ **Independent Quotes with Size**

Market makers enter their quotes into the ISE's central orderbook as firm bid and ask quotations. Market makers are required to maintain their quotes in the market, with a maximum spread and for a minimum quantity, in the options to which they are assigned. The ISE is the first U.S. options exchange to display size associated with the best bid and offer.

### ➤ **Automatic Order Execution**

Members are able to submit, amend and cancel orders in the central orderbook. Orders in the orderbook are executed in price priority. Within price priority, customer orders are executed first based upon time of entry. The remainder is shared pro-rata among non-customers based upon the size of their orders and quotes.

### ➤ **Block Orders**

The Block Order Mechanism is available for EAMs to use when executing large orders. The Block Order Mechanism allows an EAM to anonymously obtain liquidity from market participants.

### ➤ **Facilitation Orders**

An EAM may attempt to execute as principal its own block size agency orders through the Facilitation Mechanism. The EAM must be willing to be the counter-party for the entire size of the facilitation order. The EAM will trade with at least 40% of the facilitation order, after existing customer orders are filled. The remainder of the facilitation order is available to other market participants.

### ➤ **Order Types**

In addition to the special orders described above, the ISE accepts the following common order types: market orders, standard limit orders, Fill or Kill limit orders, and Immediate or Cancel limit orders. These are described in detail in the *Guide for Electronic Access Members*.

## **Open Interface**

The ISE's open interface allows members the flexibility to connect quoting, order routing and risk management systems directly to the central exchange system. Members may develop their own trading applications or purchase applications from third party suppliers. All non-ISE supplied applications are subject to conformance and connectivity tests prior to connection to the ISE production system.

## **Existing Order Routing Systems**

In addition to open interface capabilities, members with an existing order routing system may utilize a protocol conversion facility provided by the ISE. This allows the connection of order routing systems to the ISE without the need to develop to a new protocol.

## **Trading Support**

An experienced staff is available to help the ISE's members resolve problems or answer questions. The ISE has established the market control group for trading support, a help desk to resolve technical issues, and Member Services to provide connectivity and open interface support.

## **Member Checklist**

The following list of activities will prepare member firms for trading at the ISE.

Establish contact with the ISE to ensure that we have your contact details and site address.	
Purchase or lease membership(s) from ATP (market makers only).	
Apply to the ISE for membership approval.	
Assure that your order routing system or provider has connectivity to the ISE.	
Prepare site and trading desk, including installation of communications equipment cabinet, trading LAN and trader workstation PCs.	
Arrange training and examination of Designated Trading Representatives (market makers only).	



## **ISE Contacts**

**Richard Pombonyo**, VP Marketing – first point of contact for member firms

(212) 897-0250

**Gregory Maynard**, VP Member Services – assistance with all aspects of technical connection to the ISE

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For more information, visit our web site at [www.iseoptions.com](http://www.iseoptions.com) or email us at [mail@iseoptions.com](mailto:mail@iseoptions.com).

## **ATP Contacts**

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