INTERNATIONAL SECURITIES EXCHANGE

Regulatory Information Circular			
Circular Number:	2003-11	**Contact:**	Jim Sampson, VP Market Supervision
Date:	June 30, 2003	**Telephone**:	212/897-0235

Subject: Amendment to Obvious Error Rule

ISE has received SEC approval of an amendment to Rule 720 (the "Obvious Error Rule") (Release No. 34-48097). Below is an overview of the most significant changes to the Rule. Attached is the Rule with all of the changes marked. These changes are effective immediately.

Determining Whether Or Not An Obvious Error Has Occurred

Under the Rule, a trade must occur at a price that qualifies as an obvious error.

- In determining whether the price of a trade qualifies as an obvious error, the Rule has been amended to look at the opposite side of the market. Specifically, the Theoretical Price for trades caused by erroneous buy orders or bid quotes will be determined by the offer from the other options exchange with the most volume in the options class. The Theoretical Price of trades caused by erroneous sell orders or offer quotes will be determined by the bid from the other options exchange.

- Because the side of the market to which the rule will look to determine the Theoretical Price has switched, the required deviation necessary for a trade to qualify as an obvious error has been reduced to the amount equivalent to the maximum bid/ask spread for the series, rather than a multiple of the allowable spread. There will no longer be a different standard for options priced under $3, although there is a new "nickel rule" for very low priced options (discussed below).

- The rule's distinction between regular market conditions and fast market conditions has been eliminated.

Adjustment Prices

Under the Obvious Error Rule, qualifying trades between two ISE market makers are adjusted by Market Control unless both parties agree to bust the trade.

- The Rule has been amended to remove consideration of which order or quote was in the market first. Instead, the same adjustment standard will be applied to all executions that qualify as an obvious error.

- The price to which Market Control will adjust trades has been amended: erroneous buy executions will be adjusted to the Theoretical Price (the offer) plus $.15 for options under $3, and plus $.30 for options as or above $3; erroneous sell executions will be adjusted to the Theoretical Price (the bid) minus $.15 for options under $3, and minus $.30 for options at or above $3.

The "Nickel Rule"

The Obvious Error Rule did not contain any special criteria for executions in options with a quote of $0 to $.05 (no bid, offered at a nickel).

- The Rule has been amended to provide that buyers of options priced at no bid, offered at a nickel may request that their execution be busted if at least the three strike prices below (for calls) or above (for puts) in the same class were quoted no bid, offered at a nickel at the time of the erroneous execution.

Please contact me if you have any questions.

Attachment

Text of the Rule Change

Underlining indicates additions; [brackets] indicate deletions.

Rule 720. Obvious Errors

The Exchange shall either bust a transaction or adjust the execution price of a transaction that results from an Obvious Error as provided in this Rule.

(a) *Definition of Obvious Error.* For purposes of this Rule only, an Obvious Error will be deemed to have occurred when the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least the amount shown below:

Theoretical Price	**Minimum Amount**
Below $2	.25
$2 to $5	.40
Above $5 to $10	.50
Above $10 to $20	.80
Above $20	1.00

[(1) if the Theoretical Price of the option is less than $3.00:

(i) during regular market conditions (including rotations), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount of 35 cents or more; or

(ii) during fast market conditions (i.e., the Exchange has declared a fast market status for the option in question), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount of 50 cents or more.

(2) if the Theoretical Price of the option is $3.00 or higher:

(i) during regular market conditions (including rotations), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least two (2) times the maximum bid/ask spread allowed for the option, so long as such amount is 50 cents or more; or

(ii) during fast market conditions (i.e., the Exchange has declared a fast market status for the option in question), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least three (3) times the maximum bid/ask spread allowed for the option, so long as such amount is 50 cents or more.]

(b) *Definition of Theoretical Price.* For purposes of this Rule only, the Theoretical Price of an options series is:

(1) if the series is traded on at least one other options exchange, the last bid price with respect to an erroneous sell transaction, [or] and last offer price with respect to an erroneous buy transaction, just prior to the trade, [found on] disseminated by the competing options exchange that has the most liquidity in that option [as provided in Supplementary Material .02 below]; or

(2) if there are no quotes for comparison purposes, as determined by designated personnel in the Exchange's market control center ("Market Control").

[(c) *Adjustments*. Where the execution price of a transaction executed as the result of an Obvious Error is adjusted, the adjusted price will be:

(1) the Theoretical Price of the option in the case where the erroneous price is displayed in the market and subsequently executed by quotes or orders that did not exist in the System at the time the erroneous price was entered; or

(2) the last bid or offer, just prior to the trade, found on the exchange that has the most liquidity in that option as provided in Supplementary Material .03 below in the case where an erroneous price executes against quotes or orders already existing in the System at the time the erroneous price was entered.]

[(d)] (c) *Obvious Error Procedure.* Market Control shall administer the application of this Rule as follows.

(1) Notification. If a market maker on the Exchange believes that it participated in a transaction that was the result of an Obvious Error, it must notify Market Control within five (5) minutes of the execution. If an Electronic Access Member believes an order it executed on the Exchange was the result of an Obvious Error, it must notify Market Control within twenty (20) minutes of the execution. Absent unusual circumstances, Market Control will not grant relief under this Rule unless notification is made within the prescribed time periods.

(2) Adjust or Bust. Market Control will determine whether there was an Obvious Error as defined above. If it is determined that an Obvious Error has

occurred, Market Control shall take one of the [following] actions listed below.[:] Upon taking final action, Market Control shall promptly notify both parties to the trade.

(i) [w]Where each party to the transaction is a market maker on the Exchange, the execution price of the transaction will be adjusted by Market Control to the prices provided in paragraphs (A) and (B) below unless both parties agree to adjust the transaction to a different price or agree to bust the trade within ten (10) minutes of being notified by Market Control of the Obvious Error.[; or]

(A) Erroneous buy transactions will be adjusted to their Theoretical Price (1) plus $.15 if the Theoretical Price is under $3, and (2) plus $.30 if the Theoretical Price is at or above $3.

(B) Erroneous sell transactions will be adjusted to their Theoretical Price (1) minus $.15 if the Theoretical Price is under $3, and (2) minus $.30 if the Theoretical Price is at or above $3.

(ii) [w]Where at least one party to the Obvious Error is not a market maker on the Exchange, the trade will be busted by Market Control unless both parties agree to [adjust the] an adjustment price [of] for the transaction within thirty (30) minutes of being notified by Market Control of the Obvious Error. [Upon taking final action, Market Control shall promptly notify both parties to the trade.]

(e) *Obvious Error Panel*.

(1) Composition. An Obvious Error Panel will be comprised of representatives from four (4) Members. Two (2) of the representatives must be directly engaged in market making activity and two (2) of the representatives must be employed by an Electronic Access Member.

(2) [Request for] Scope of Panel's Review. If a party affected by a determination made under this Rule so requests within the time permitted in (3) below, the Obvious Error Panel will review decisions made by Market Control under this Rule, including whether an Obvious Error occurred, whether the correct Theoretical Price was used, and whether an adjustment was made at the correct price. A party may also request that the Obvious Error Panel provide relief [under] as provided in this Rule in cases where the party failed to provide the notification required in paragraph [(d)](c)(1) and Market Control declined to grant an extension, but unusual circumstances must merit special consideration.

(3) Procedure for Requesting Review. A request for review must be made in writing within thirty (30) minutes after a party receives verbal notification of a final determination by Market Control under this Rule, except that

if notification is made after 3:30 p.m. Eastern Time, either party has until 9:30 a.m. Eastern Time the next trading day to request review. The Obvious Error Panel shall review the facts and render a decision on the day of the transaction, or the next trade day in the case where a request is properly made after 3:30 on the day of the transaction or where the request is properly made the next trade day.

[(3)] (4) Panel Decision. The Obvious Error Panel may overturn or modify an action taken by Market Control under this Rule upon agreement by a majority of the Panel representatives. All determinations by the Obvious Error Panel shall constitute final Exchange action on the matter at issue.

Supplementary Material to Rule 720

[.01 For purposes of paragraph (a) of this Rule, the maximum bid/ask spread shall be the maximum bid/ask spread allowed under Rule 803(b), unless a wider spread has been allowed by the Exchange for the option because of unusual market conditions, such as high market volatility.

.02 The Theoretical Price will be determined under paragraph (b)(1) above as follows: (i) the bid price from the exchange providing the most volume will be used with respect to an erroneous bid price entered on the Exchange, and (ii) the offer price from the exchange providing the most volume will be used with respect to an erroneous offer price entered on the Exchange.

.03 The price to which a transaction is adjusted under paragraph (c)(2) above will be as follows: (i) the bid price from the exchange providing the most volume for the option will be used with respect to an erroneous offer price entered on the Exchange, and (ii) the offer price from the exchange providing the most volume for the option will be used with respect to an erroneous bid price entered on the Exchange. If there are no quotes for comparison purposes, the adjustment price will be determined by Market Control.]

[.04] .01 When Market Control determines that an Obvious Error has occurred and action is warranted under paragraph [(d)](c)(2) above, the identity of the parties to the trade will be disclosed to each other in order to encourage conflict resolution.

[.05] .02 To qualify as a representative of an Electronic Access Member on an Obvious Error Panel, a person must (i) be employed by a Member whose revenues from options market making activity do not exceed ten percent (10%) of its total revenues; or (ii) have as his or her primary responsibility the handling of Public Customer orders or supervisory responsibility over persons with such responsibility, and not have any responsibilities with respect to market making activities.

[.06] .03 The Exchange shall designate at least ten (10) market maker representatives and at least ten (10) Electronic Access representatives to be called upon to serve on Obvious Error Panels as needed. In no case shall an Obvious Error Panel include a person related to a party to the trade in question. To the extent reasonably possible, the Exchange shall call upon the designated representatives to participate on an Obvious Error Panel on an equally frequent basis.

[.07] .04 All determinations made by the Exchange, Market Control or an Obvious Error Panel under this Rule shall be rendered without prejudice as to the rights of the parties to the transaction to submit a dispute to arbitration.

.05 Buyers of options with a zero bid and $.05 offer (i.e., a Theoretical Price of $.05) may request that their execution be busted if at least the three strikes below (for calls) or above (for puts) in the same options class were quoted with a zero bid and $.05 offer at the time of the execution. Such buyers must follow the procedures of paragraph (c)(1) above.

.06 For purposes of paragraph (b)(1) of Rule 720, the competing options exchange with the most liquidity will be the options exchange that had the highest total contract volume in the options class for the previous two months (e.g., if an obvious error occurs on March 9, the total contract volume from January 8 to March 8 will be used).

.07 For purposes of Rule 720, an “erroneous sell transaction” is one in which the price received by the person selling the option is erroneously low, and an “erroneous buy transaction” is one in which the price paid by the person purchasing the option is erroneously high.