

Preliminary Exchange Notice 2000-1

To: Prospective ISE Members

Date: February 29, 2000

Re: Amendments to ISE Rules

We are pleased to announce that on February 24, 2000, the Securities and Exchange Commission (“SEC”) approved the ISE’s registration as an exchange. We are now able to proceed with critical membership initiatives, such as receiving, processing and approving applications for membership, election of the initial board of directors, and establishing various Exchange Committees. During this interim period between our new regulatory status as an exchange and establishment of our governance infrastructure, we will periodically send to our prospective members these Preliminary Exchange Notices (“PENs”) to keep you informed of what is happening at the ISE.

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As a result of negotiations with the SEC, the ISE made certain changes to its rules just prior to receiving SEC approval of its application for registration. This PEN will briefly describe the most significant of these changes. For a more detailed description of all of the changes and the actual rule language, please access the ISE’s web site at www.iseoptions.com and go to the “Password Users Only” section and fill in the User Name: ise; Password: global (case sensitive).

- **Board Vote:** The ISE had proposed that any changes to the ISE would require the approval by a majority of the entire ISE board of directors, but that rule changes could not be approved unless at least one of the PMM directors and at least one of the CMM directors agreed. In effect, this meant that either the PMM directors or CMM directors could prevent board approval of rule changes. The ISE proposed this approval requirement because it believed special protections were necessary for PMM and CMM members, as each type of membership has an equity interest in the Exchange and each type has only two representatives out of the 15 directors on the board. However, the SEC believed that the approval requirement was in conflict with having a board containing a majority of non-industry directors. To address the SEC’s concern, the ISE amended the provision to provide that the PMM and CMM directors cannot over-ride a board decision to approve a rule change if a majority of the non-industry directors are in favor of the rule change. The ISE

believes that this compromise will continue to protect the interests of PMM and CMM members.

- **Diversity of Membership:** The SEC requested that ISE further clarify under what conditions it might approve a member to operate more than one PMM membership. While the ISE provided general guidelines that the board will follow when considering whether to make such an approval, it also represented that it generally anticipates granting such an approval on a temporary basis when needed to address mergers, acquisitions and similar business combinations, as the ISE's goal is to have as widespread and dispersed membership as possible. Management currently anticipates recommending that the Board only permit Adirondack Trading Partners ("ATP") to operate two PMM memberships due to ATP's unique position in funding the Exchange and the fact that ATP is owned by a consortium of broker-dealers, therefore representing widespread ownership in the securities industry.
- **Facilitation Mechanism:** At this time, the SEC is unwilling to approve a facilitation guarantee (for any options exchange) that exceeds 40% of the original order size. Accordingly, the ISE reduced from 50% to 40% the facilitation guarantee for Electronic Access Members using the Facilitation Mechanism.
- **Limitations on Orders:** The ISE had proposed that no electronically generated orders could be entered by an EAM. In the interest of promoting competition and narrower spreads, the SEC requested that the ISE permit electronically generated non-marketable limit orders that improve the best bid or offer on the Exchange.
- **Cash Distribution:** The SEC believes that it would be inappropriate to make cash distributions to the LLC owners from revenue raised through regulatory fees or regulatory penalties. Accordingly, the ISE adopted an interpretation that the Board will not make cash distributions (above the amount required for tax purposes) of such revenues.

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