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July 25, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number SR-C2-2011-008

Dear Ms. Murphy:

The captioned proposed rule change filing would permit the listing and trading on C2 Options Exchange, Incorporated ("C2" or "Exchange")[1] of Standard & Poor's 500 ("S&P 500") index options with third-Friday of the month expiration for which the exercise settlement value would be based on the index value derived from the closing prices of component securities (p.m.-settled) ("SPXPM"). On June 3, 2011, the Securities and Exchange Commission ("SEC" or "Commission") issued an order (the "Order") instituting proceedings to determine whether to approve or disapprove the proposed rule change. In response to that Order, comment letters were submitted to the Commission by C2, Exchange Capital Resources, and the International Securities Exchange, LLC ("ISE").

This letter responds to the two main points raised by the ISE's comment letter. First, ISE notes that U.S. equity markets are more fragmented than they were in 1987 and concludes, "[t]hese stark changes in trading patterns present a clear warning against returning to P.M. settlement." Second, ISE states that approval of SPXPM "will lead to the reintroduction of multiple P.M.-settled derivatives" and concludes that the collective effect of these other products—which have neither been proposed nor approved—would "seriously undermine the industry-wide move to A.M. settlement." For the reasons discussed below, we strongly disagree with ISE's conclusions. As we stated in our previous correspondence to the Commission regarding the SPXPM proposal, we believe the proposal is consistent with the requirements of the Securities Exchange Act of 1934

[1] C2 and the Chicago Board Options Exchange, Incorporated ("CBOE") are wholly-owned subsidiaries of CBOE Holdings, Incorporated.

(the "Act"), would provide benefits to investors, and should be approved by the Commission on a pilot basis.

Today's Equity Market Structure

In its comment letter, ISE focuses on the increased "fragmentation" of U.S. equity markets since 1987, citing the increased number of trading venues for equities, including exchanges, dark pools, and electronic communication networks. From this, ISE concludes that today's equity markets are not equipped to handle potential increased volume that it believes could result from p.m.-settled options contracts. Not only do we strongly disagree with that conclusion, we believe that the increase in the number and types of trading venues and market participants—and, as importantly, the significant improvement in the closing procedures of the New York Stock Exchange ("NYSE")—reduce any potential volatility or liquidity risks associated with p.m. settlement. Our belief is reinforced by recent academic evidence showing that market quality metrics have improved over the past two decades at the same time U.S. equity markets have become more diverse.[2]

As we discussed in our July 11 comment letter and as noted by Exchange Capital Resources in its comment letter, liquidity issues associated with p.m. settlement in 1987 should be attributed to the system in place at that time. Any meaningful assessment must take into account that a single NYSE specialist was obligated to handle all imbalances in a particular security at market close. The decision to transition *some* products to a.m. settlement over 24 years ago was a reflection of the difficulties experienced at that time by NYSE specialists to *manually* close stocks when greater than normal Market on Close ("MOC") interest accumulated near the end of the trading day.

NYSE has significantly changed and improved its closing process since 1987, as was acknowledged by ISE in its comment letter. The advanced closing process in place today at NYSE (and NASDAQ) is well-structured to handle any potential incremental volume associated with a p.m.-settled cash index product. Our expectation is that derivative traders will generally seek closing fills on the primary market for the stocks underlying SPXPM. Approximately 400 of the 500 S&P 500 index stocks are listed on the NYSE. Even though NYSE's market share in equity volume has declined since 1987, NYSE processes dramatically more volume now than it did in 1987 and, in our view, would be able to handle any additional trading volume on SPXPM expiration dates given the closing procedures that it now has in place.

Further alleviating concerns about liquidity and volatility, a substantial number of liquidity providers now participate on NYSE, including at the close of market trading. More equity trading venues handle MOC orders today than in 1987, which affords traders and investors with more alternatives with respect to where to transmit MOC interest and provides liquidity providers in the primary equity markets other venues and pools of

[2] See Tarun Chordia, Richard Roll, and Avanidhar Subrahmanyam, "Recent Trends in Trading Activity and Market Quality," Emory Law and Economics Research Paper No. 10-88. (2010) Available on SSRN.

liquidity to help offset risk. These developments should reduce—not increase—potential concerns over liquidity and volatility at the close.

We note that ISE provides no data to support its conclusion that an increase in the number of trading venues and equity market participants decreases equity market liquidity. Instead, ISE cites to the Commission's May 6, 2010 report on the "flash crash." We do not believe that the issues identified and the conclusions drawn by the Commission in its flash crash report are applicable in the context of the SPXPM proposal.

First, the flash crash did not occur at the close of trading and did not involve order accumulation on one particular market center. Second, SPXPM expiration dates are predetermined and would be known in advance by market participants, which is in stark contrast to what happened on May 6, 2010, when stock market participants were caught by surprise and where unusual trading activity led to market confusion. In advance of expirations, market participants would be expecting index option traders to seek closing price executions in specified stocks. Awareness of potential increased trading around SPXPM expirations is useful to liquidity providers in the equity markets and would facilitate the generation of contra-side trading interest. Third, traders would not be submitting rapid-fire cancel/replace orders as a result of SPXPM expirations; instead they would get their desired stock trades done at the *closing* price. For those reasons, we believe that ISE's analogy of SPXPM expirations to the "flash crash" is inapposite and that the increased "fragmentation" of U.S. equity markets should result in less concern about liquidity and volatility in connection with the SPXPM proposal.

Expansion of P.M.-Settled Derivatives

We are aware of no evidence to support an argument that SPXPM would cause market disruption, and ISE presents none in its comment letter. ISE instead takes the position that the Commission's process for approving pilot products is ineffective, with the consequence that approval of the SPXPM pilot program would lead not only to the permanent availability of SPXPM, but also to the approval—on a permanent basis—of scores of additional products that *collectively* could disrupt the market.

We do not believe that the potential for other p.m.-settled products being submitted to the SEC or the CFTC should be considered by the SEC in assessing whether the SPXPM proposal is consistent with the Act. We detailed in our July 11 letter why the SPXPM proposal is consistent with the requirements of the Act—including that the proposal is designed to attract current users of OTC S&P 500 options, is in the public interest in that it adds transparency to OTC transactions, greatly reduces counterparty risk, helps systematically important dealer banks better manage their risk from OTC dealing, and furthers the objectives of the Dodd-Frank Act by adding increased transparency and reducing systemic risk in the OTC derivatives markets. Moreover, p.m.-settled options currently exist, and the Commission has approved p.m. settlement for cash-settled index options on several occasions in the past few years. If other p.m.-settled products are submitted to the SEC or CFTC by C2 or others, the SEC or CFTC can and should assess the market benefits (or detriments) of those products at that time.

We submit that, contrary to ISE's assertion, pilot programs are an important mechanism to foster product development while providing the Commission and its staff with the ability to effectively monitor and, if needed, to limit trading of a particular product. We also seriously disagree with ISE that the approval of one or more p.m. pilots would make it difficult to ascertain whether the new p.m.-settled products caused market disruptions. Equity market order increases related to p.m. settlement occur on certain known dates and at the end of the trading day. The ability to analyze those known time periods would seem to be relatively straightforward. Indeed, in our July 11 letter we presented the Commission with evidence of end-of-day trading activity with respect to similar p.m.-settled options products, including robustly-traded SPX end-of-week options, which showed that there was no meaningful price volatility at the close on those expiration dates. By contrast, ISE asks the Commission to disapprove our product based on *speculation* that the Commission will recklessly approve pilots in the future and not adequately monitor those pilots before making them permanent. Mere speculation is not a sufficient basis for agency decision-making.[3] We believe that the SPXPM pilot program would allow the Commission and its staff to effectively monitor any effects of SPXPM on U.S. equity markets.

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C2 appreciates the opportunity to respond to ISE's comments on our proposed rule filing to list and trade p.m.-settled S&P 500 index options pursuant to a pilot program. Please do not hesitate to contact me at (312) 786-7001, Joanne Moffic-Silver, Executive Vice President and General Counsel, at (312) 786-7462 or Angelo Evangelou, Assistant General Counsel, at (312) 786-7464 if you would like to discuss our views further or if you would like additional information.

Sincerely,

William J. Brodsky

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cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisse B. Walter, Commissioner
Robert W. Cook, Division of Trading and Markets
James A. Brigagliano, Division of Trading and Markets
Heather Seidel, Division of Trading and Markets
Richard Holley III, Division of Trading and Markets
Craig Lewis, Division of Risk, Strategy, and Financial Innovation

[3] *See Natural Resources Defense Council, Inc. v. EPA*, 859 F.2d 156, 210 (D.C. Cir. 1988) ("mere speculation . . . [is] not [an] adequate ground[] upon which to sustain an agency's action").