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May 11, 2011

Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. SR-C2-2011-08

Dear Ms. Norris:

The International Securities Exchange, LLC ("ISE") previously submitted a comment letter[1] on the above referenced proposal ("Proposal") of the C2 Options Exchange ("C2")[2]. In this Proposal, C2 seeks approval to trade options ("C2 options") on the Standard & Poor's 500 Index ("S&P 500") that have very minor differences from the options on the S&P 500 ("SPX options") currently traded on the Chicago Board Options Exchange ("CBOE"). C2 submitted a letter discussing our comments, but did not actually address the issues we raised.[3] We continue to believe that the Proposal is inconsistent with the Securities Exchange Act of 1934 ("Act") and urge the Commission to disapprove the Proposal. Below we respond to each point C2 addressed in its letter.

1. Linkage. Purposely or not, C2 misconstrued our argument and did not address the substance of our comment. We fully agree that the C2 options and the SPX options would not be fungible and therefore would not be subject to trade-through protection under the Options Linkage Plan. Indeed, it is the fact that C2 is proposing to list an options contract that is only slightly different from, and therefore not fungible with, the SPX option, that is the problem. As we discussed in detail, the Proposal is specifically designed to ensure that CBOE Holdings can protect its existing monopoly over SPX options on its floor, while introducing electronic trading in essentially the same product. This will deny investors the trade-through protection that would be available for fungible products. We urge the Commission not to allow CBOE Holdings to use its two exchange registrations and a slightly modified contract to accomplish such a blatant end-run around the national market system mandated by Section 11A of the Act.

2. Investor Confusion. C2 first dismisses our comment by identifying that there are many products traded on the S&P 500 index, such as FLEX options, S&P 500-based ETFs and ETF options, and S&P 500 futures, as well as S&P 500 options

[1] Letter from Michael J. Simon, Secretary, ISE, March 29, 2011.
[2] Release No. 3464011 (March 2, 2011), 76 F.R. 12775 (March 8, 2011).
[3] Letter from Joanne Moffic-Silver, Secretary, C2 Options Exchange, Incorporated, April 20, 2011.

with different exercise styles and options with settlements on the last day of each quarter, month and every Friday of the month (other than the last Friday). While this is true, none of these products are nearly as similar to the SPX option as the proposed C2 options, where there is only a 6.5 hour time difference between the expiration of otherwise identical options contracts. C2 also dismisses our comment stating that our reference to our DAX option proposal (full and mini) is misplaced because the Commission staff's concerns were in regard to scaled contracts on the same index, a concern that does not apply to the C2 Proposal. Again, C2 failed to address the substance of our comment: the Commission now scrutinizes new product proposals against a wide range of policy concerns, including investor confusion and fragmentation. Listing both A.M.- and P.M.-settled S&P 500 options that are nearly indistinguishable will be completely lost on investors and is in conflict with the policy overlays the Commission now applies to the listing of new derivative products.

3. P.M. Settlement.

In our initial letter we detailed why a move back to P.M. settlement poses significant investor protection concerns. Not only are there demonstrated historical problems from the time the Commission permitted such settlements, but events such as the "flash crash" show that the current market structure still struggles to find price equilibriums in times of market stress. C2 ignores these facts. Rather, they argue that the markets have changed in the last 10 years, and that any lingering concerns are addressed by proposing this as a "pilot program" that it can quickly end if need be. However, we believe that structural changes in the last 10 years actually raise greater concerns about P.M. settlement, and that calling this a "pilot" does not relieve C2 of the burden of explaining that its Proposal complies with the Act. C2 has failed to meet that burden.

As to changes in the market in the last 10 years, C2 argues that the New York Stock Exchange ("NYSE") is now more automated, and that specialists have a reduced role. They also point to the institution of the NYSE's "Liquidity Replenishment Points." C2 implies that these changes mitigate the concerns of P.M. settlement. However, C2 fails to recognize that none of these changes significantly addresses volatility concerns associated with P.M. settlement. Indeed, all of these market changes were in effect last year, and they failed to prevent the flash crash. In fact, the changes in the market over the last 10 years actually exacerbate the potential problems with P.M. settlement.

C2 correctly notes that the equities markets are more fragmented now than in 2000. While C2 implies that this somehow supports a return to P.M. settlement, the reality is that fragmented markets enhance volatility. At times of market stress, the key to market stability is to channel as much trading interest into a single price-discovery mechanism as possible to find an equilibrium price. That is precisely the structure of the market opening, and that is why the Commission moved the index options markets to A.M. settlement. In contrast, fragmentation results in market participants chasing liquidity across multiple venues in times of stress, exacerbating incidents such as the flash crash. Given the lingering effects of the flash crash on investor confidence, now is exactly the wrong time to experiment with a P.M. settlement index option that could destabilize the markets.

We do not understand the concept of a pilot in this circumstance. Allowing a severe market disruption to confirm that P.M. settled options pose too much risk to the market would hardly seem to be a prudent regulatory approach. Typically, the Commission will employ a pilot to study the longer term effects of a change on market structure. The C2 proposal for a pilot does not conform to that precedent and creates additional risk of market disruption that could have potential for both immediate and long-lasting effects. We believe that the goal should be to limit circumstances that could give rise to flash crash types of situations, not to react after-the-fact to such events.

4. Position Limits. We agree with the substance of C2's argument that the Dutt-Harris model should be applied in a manner that reflects the risk of manipulation of the underlying index value, which may be mitigated by effective surveillance. Notwithstanding our agreement on that point, it remains anti-competitive for Commission staff to apply its current interpretation of the Dutt-Harris model inconsistently, as C2 proposes. As we noted, the Commission staff has recently taken a different view with respect to position limits and considers certain options "grandfathered" from this more conservative approach. C2 failed to respond to our comment that if it were to list a non-fungible option on the S&P 500 index, such new product should be subject to the current policy approach and not "grandfathered."

5. Exclusive Listings. The Act mandates fair competition among exchanges because it assures the best quality of markets for investors at competitive prices. Contrary to C2's assertion, our petition would not strip an index owner of its property right to decide who may license its index as the basis of index options. Rather, it would assure that products traded on registered national securities exchanges are open to competition by prohibiting registered exchanges from entering into exclusive arrangements. There is an important distinction between transactions negotiated off-exchange and those executed on an exchange that cannot be ignored: when the investing public purchases securities on a registered national securities exchange in the United States, they have an expectation that their orders are being executed in a robust competitive market that assures the best execution of their orders. That is simply not the case with respect to SPX options. U.S. investors are being held hostage by CBOE Holding's exclusive licensing arrangement for options on the S&P 500, and the Commission should not permit this to continue.

* * *

C2 is not simply proposing an alternative to an OTC-traded product. If so, CBOE would have proposed to list the contract long ago, and CBOE Holdings would list both products on both of its registered exchanges. Under this reasoning, all of the options exchanges should start listing both European and American style options on all options products. The Proposal to list a contract on C2 that is only slightly different from one of the most popular listed options contracts is intended to introduce electronic trading in SPX options in a way that protects the CBOE floor at the expense of the investing public. The Proposal is harmful to investors because it circumvents the protections of the national market system and perpetuates the unreasonably high monopolistic pricing and artificially wide spreads that result from the lack of competition in this product. In fact, it has been reported that CBOE Holding's CFO, Alan Dean, has confirmed the intention to price the C2 options similarly to the SPX options to avoid "fee arbitrage" between the products.[4] Whether or not the Commission is willing to address the tangible harm to investors caused by the exclusive listing of SPX options on the CBOE, it should not allow CBOE Holdings to perpetuate this harm through introduction of an almost identical product that poses systemic risk to the U.S. financial markets and removes investors' right to trade-through protection.

We urge the Commission to disapprove the C2 Proposal to list P.M.-settled S&P 500 options. If you have any questions on our comments, or if we can be of further help to the Commission on this matter, please do not hesitate to contact us.

Sincerely,

Michael J. Simon
Secretary

cc: Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets

[4] *See, e.g.,* Trading Talk, Rosenblatt Securities Inc., May 5, 2011 (discussing CBOE Holding's Q1 earnings call on May 5, 2011).