International Securities Exchange

July 28, 2015

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. SR-EDGX-2015-18

Dear Mr. Fields:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the above-referenced proposed rule filing in which EDGX Exchange, Inc. ("EDGX") proposes to adopt rules governing options trading. The proposed options rules include a novel five-lot entitlement for Directed Market Makers ("DMMs") that we believe would foster the internalization of orders to the detriment of investors and other options market participants.[1] We thus urge the Commission not to approve the proposed rule change unless EDGX eliminates this provision.

In recognition of their unique obligations to the market, Primary Market Makers ("PMMs") on ISE and their counterparts at other options exchanges receive a special allocation entitlement when trading against small size orders of five contracts or fewer.[2] Specifically, provided there are no customer orders on the book with priority, an ISE PMM quoting at the best price is entitled to execute the entirety of an order for five contracts or fewer, up to the size of its quote. In its filing to establish rules for options trading, EDGX proposes to provide this allocation entitlement not only to the PMM appointed in the class, but also to ordinary market makers that receive directed orders, i.e., DMMs.[3]

[1] This comment letter focuses on the proposed five lot entitlement for DMMs and does not address other aspects of the proposed EDGX options rules.
[2] See e.g. Supplementary Material .01(c) to ISE Rule 713.
[3] See Proposed EDGX Rules 21.8(f)-(h).

Generally, DMMs or Preferenced Market Makers as other exchanges refer to them, who do not act in the capacity of a PMM or specialist receive only one special entitlement: the right to trade against 40 percent of an incoming order directed or preferenced to them, regardless of the size of the order.[4] In contrast, EDGX is proposing to grant DMMs the special entitlement of trading against all orders of five contracts or fewer. This is an unprecedented change, and is not justified in the EDGX filing. Indeed, it is a significant departure from the Commission approved allocation entitlements in place on other markets, and would allow EDGX members to internalize virtually all small size orders by directing these orders to their affiliates.

The internalization concerns the EDGX filing raises will multiply as the other options exchanges face competitive pressures to adopt similar rules for DMMs in their respective markets. Indeed, due to intense competition in the options industry, we expect that ISE and each of the other options exchanges would have little choice but to copy this proposed rule if approved.[5] This would result in significantly more internalization as members could split up larger orders and preference them to their affiliated DMMs making markets on different exchanges. If the EDGX options filing is approved, and each of the twelve other options exchanges were to adopt a similar rule, a member could split up an order of up to 65 contracts into five lot orders to be directed to their affiliated DMMs across each of the options exchanges. This would be a huge competitive burden on firms that do not have affiliated DMMs, and would reduce incentives for market makers to quote deep and competitive markets.

The EDGX proposal also is inconsistent with the goals of the allocation entitlement as expressed in the initial ISE filing introducing this entitlement in 2000, and the Commission order approving that proposed rule change.[6] Specifically, the PMM entitlement for small size orders was designed to balance the obligations that the PMM has to the exchange with appropriate rewards that encourage the maintenance of quality markets. This balance is disrupted by providing the same rewards to DMMs who receive orders preferenced to them by their affiliates, and who generally have lesser obligations to assist in the maintenance of a fair and orderly market.[7] ISE does not believe that it is appropriate to extend this valuable entitlement for small size orders to members with reduced obligations to the market.

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[4] The exact allocation entitlement depends on the number of professional orders or market maker quotes at the best price. <u>See</u> <u>e.g.</u> Supplementary Material .03(c) to Rule 713.

[5] If the EDGX options rules are approved, other options exchanges would be able to quickly introduce similar rules through non-controversial "copycat" rule filings that qualify for immediate effectiveness pursuant to Rule 19b-4(f)(6).

[6] <u>See</u> Securities Exchange Act Release Nos. 42472 (February 29, 2000), 65 FR 11823 (March 6, 2000) (Notice); 42808 (May 22, 200), 65 FR 34515 (May 30, 2000) (Approval) (SR-ISE-00-01).

[7] We further note that PMMs on EDGX will have lessened obligations than PMMs on the ISE, since EDGX PMMs will be obligated to maintain continuous quotations in only 75 percent of appointed series, instead of all appointed series.

For the reasons described above, ISE believes that the proposed EDGX options rules, and, in particular, the rules governing market maker entitlements are not consistent with protection of investors or the public interest. We thus respectfully ask that the Commission disapprove the proposed rule change unless EDGX eliminates this special entitlement. We thank the Commission for the opportunity to comment on this proposed rule filing. If you have any additional questions, or if we can be of further assistance in this matter, please do not hesitate to contact us.

Sincerely,

Michael J. Simon,
Secretary and General Counsel