INTERNATIONAL SECURITIES EXCHANGE.

60 Broad Street, New York, NY 10004
TEL: 212 943-2400
FAX: 212 425-4926
www.ise.com

August 20, 2009

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AUG 21 2009
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Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-0609

Re: File No. SR-ISE-2009-35

Dear Ms. Murphy:

We submit this letter in response to the comments submitted to the Commission by the Chicago Board Options Exchange ("CBOE")[1] and Susquehanna International Group, LLP ("SIG")[2] on the above-referenced rule filing in which the International Securities Exchange, LLC ("ISE") proposes to adopt a Qualified Contingent Cross Order.[3] The CBOE's comments reflect a fundamental misunderstanding of the purpose of the proposed rule filing. The CBOE also shows a lack of understanding as to how stock-option orders are executed under the Commission's exemption from trade-through liability for Qualified Contingent Trades ("QCTs").[4] SIG's opposition to our proposal rests on an incorrect presumption regarding the Commission's QCT exemption and also fails to provide any valid legal or policy objections to our proposed Qualified Contingent Cross Order. As a general matter, both comment letters fail to raise any legal issues under the Securities Exchange Act of 1934 (the "Exchange Act"). Accordingly, we urge the Commission to approve the proposal.

The CBOE Fails to Recognize the Difference Between "Net Price Executions" of Complex Trades and Executions of Stand-Alone Options Orders

Market participants negotiate stock-option orders on a "net price" basis, that is, a price that reflects the total price of both the stock and options legs of the trade. Once the parties have agreed to a net price, the options component and stock component are executed separately in the options and equity markets.

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[1] Letter from Angelo Evengelou, Assistant General Counsel, CBOE, dated July 16, 2009.
[2] Letter from Gerald D. O'Connell, Chief Compliance Officer, SIG, dated August 10, 2009.
[3] Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009) (Notice for ISE-2009-35).
[4] Securities Exchange Act Release No. 57620 (April 4, 2008) (the "QCT Release").

Thus, the actual execution price of each component is not as material to the parties as is the net price of the transaction. The ISE's proposal addresses the mechanics of executing the stock and options components of a net-price transaction in disparate markets with different execution rules, different trading increments and different intermarket trade-through provisions.

Under the proposal, we will not permit the options component of a stock-option order to trade through the national best bid and offer ("NBBO"), requiring that it trade at a price that matches or betters the ISE's BBO. In this regard, because the equity component of a stock-option order can be executed at any price under the QCT exemption from Regulation NMS, the pricing of the options component can be flexible. Indeed, whether the options component is executed at or between the ISE BBO is not material because, in most cases, the stock trade can be executed at a price that achieves the desired net price.[5]

However, there are times when the quotation spread for the option on the ISE would not permit an execution of the options component between the ISE BBO, particularly in options that trade in increments greater than $0.01. In those cases, we propose to permit an execution of the options component at a price that matches the ISE BBO.[6] We see no regulatory or policy reason why the options component of a stock-option order should be prevented from being executed in situations where the ISE BBO is at the minimum increment.

The CBOE further confuses the matter by misstating the Commission's QCT exception. Specifically, the CBOE states that "the SEC Qualified Contingent Trade exemption and the Complex Trade exemption only apply to stock-option trades negotiated and represented as a package." That is not correct: the Commission's QCT exemption contains no such limitation.[7] Indeed, we understand it to be accepted practice that broker-dealers regularly rely on the QCT exemption when effecting the stock and options legs of QCTs in separate markets, without ever representing the legs together as one trade on an options exchange. This clearly recognizes that the parties have negotiated a net price for the transaction and then execute the legs of the transaction in the appropriate markets.

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[5] For example, assume two parties negotiate a stock-option order to buy 100,000 shares and sell 1,000 calls with a net price of 24.38. Further assume that the NBBO for the option is $0.82 by $0.86, and that the NBBO for the stock is $25.20 by $25.21. The broker sends an order to the ISE to execute the options component at $0.85 and sends the equity component to an equities marketplace at $25.33. Note that in this example there is a range of prices at which the price of the components could be executed between the NBBO for the option, e.g., the options component could be executed at $0.83, $0.84 or $0.85, and the equity component could be executed respectively at $25.31, $25.32, or $25.33.

[6] Continuing with the example from note 4 above, assume that the NBBO and ISE BBO for the option is $0.85 by $0.86. According to the CBOE's letter, the contingent trade should not be permitted because the spread in the option is at a minimum increment.

[7] *See* the QCT Release, note 3 above.

There is No Basis for CBOE's Customer Priority Concerns

The CBOE states that our proposal "conflicts with order protection principles" by allowing executions of the options leg of a Qualified Contingent Cross ahead of customer orders resting on the ISE book. Of note, the CBOE does not cite any statue or Commission rule this would violate, only some uncited "principle." However, our proposal is consistent not only with the law, but also with established "order protection principles." As discussed in detail above, customers with orders resting on the ISE book at the execution price are not being disadvantaged because they are not bidding and offering for the contingent trade that is being executed.

Even though we do not view the execution of these orders as "trading ahead" of customers on our book, we strongly disagree with the CBOE's implication that an exchange faces a black-and-white choice: it either must maintain customer priority in all circumstances or adopt a market structure that does not provide customer priority in any circumstance. Indeed, the existing CBOE priority rules allow it to choose, on a class-by-class basis, between price-time or pro-rata priority methods, which then may be modified by one or more "priority overlays" including public customer priority.[8] With respect to the execution of the complex orders, the CBOE rules permit the execution of one leg at the same price as public customer orders on its limit order book if another leg of the order is executed at an improved price.[9] As demonstrated by the CBOE's own rules, there is no basis under the Exchange Act to assert that an exchange cannot adopt market structures and priority rules that are tailored to meet the needs of market participants, nor that public customer priority must be applied in all circumstance or not at all.

This Rule Change is Appropriate to Accommodate Distributive Linkage

The CBOE argues that we inappropriately tie our proposal to the market structure that will be in effect upon the implementation of the new distributive linkage plan.[10] Contrary to that contention, our proposal is closely tied to the new linkage plan and the rules thereunder. The current plan and implementing rules provide a full exemption from trade-through liability for block trades of 500 or more options contracts.[11] Because a particular exchange is not always at the NBBO on one or both sides of the market, the block trade-through exemption widens the range of prices at which the options component of a stock-option order may be executed currently.[12] With the removal of this exemption, it will be

[8] CBOE Rule 6.45A.
[9] *Id.* ISE has the same priority rule for the execution of complex orders. ISE Rule 722.
[10] Options Order Protection and Locked/Crossed Market Plan. Exchange Act Release No. 34-59647 (March 30, 2009), 74 F.R. 15010 (April 2, 2009).
[11] Sections 2(3) and 8(c)(i)(C) of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage; ISE Rule 1902(d)(2).
[12] *See supra*, notes 4 and 5, and accompanying text.

very difficult for the options component to be executed unless we make an accommodation that allows the execution of these orders at a price that matches the NBBO.

Ultimately, our proposed Qualified Contingent Cross is better than the current block trade exemption because it does not allow orders to trade through better prices on other exchanges, while still providing enough flexibility to allow the options component of a stock-option order to be executed. Moreover, the current linkage plan and rules allow our members to execute any trade of 500 or more contracts outside of the NBBO even when it is not tied to stock, whereas our proposal is limited to the options component of a contingent order. Thus, while the CBOE attempts to paint our proposal as creating a new and broad change to existing trading rules, in reality we are proposing a narrowing of what is available under the current rules and the linkage plan.

The CBOE's Concern Arise from Competitive, Not Legal, Concerns

While the CBOE calls for the Commission to institute proceedings to disapprove the filing, they do not at any time argue that our proposal is inconsistent with the law. They fail to cite either a single provision of the Exchange Act or a single Commission rule with which our filing conflicts. Rather, they argue that our proposal "would set a harmful precedent in the option market." Indeed, far from arguing that our proposal runs afoul of any law, they concede that "there may be a time and place to discuss as an industry" the special handling of large orders. This is a particularly troubling statement, as unlike the intermarket linkage rules, our Qualified Contingent Cross proposal does not need to be adopted by any other exchange because it is limited to the execution of orders in our market at prices that match or better the NBBO. We do not believe it would be appropriate or permissible for the exchanges to coordinate their rules in this respect.

Our filing fully complies with the Exchange Act and the Commission's rules. The CBOE does not challenge that. Rather, for what appear to be competitive reasons, they simply do not support our proposal at this time. To state the obvious, it would be anti-competitive and contrary to Section 6 of the Exchange Act (which requires the promotion of fair competition among the exchanges) for the Commission to disapprove our proposal because the CBOE has not yet determined whether it would be beneficial to adopt a similar rule in its own market.

SIG's Objections are Based on an Incorrect Presumption and Are Without Merit

SIG states that its objections to the Qualified Contingent Cross are based on pricing integrity and that approving our rule propose would "undermine" the reasons the Commission granted the QCT exemption. SIG states multiple times that the Securities Industry Association ("SIA," now "SIFMA") requested the QCT exemption based on the presumption that the stock-option net trade would be announced to a trading crowd on a net price. However, this statement is simply incorrect.

The SIA letter requesting the QCT exemption was focused solely on the need for trade-through relief. Indeed, the only time SIG actually quotes the SIA letter is to state the SIA's observation that "the proposed relief would only exempt trade-throughs related to the execution of one component order of the complex trade." That statement is correct in that the Commission only exempted the stock leg of a stock-option transaction from trade-through liability. However, what SIG fails to note is that, at the time the Commission granted the QCT exemption every options leg of a stock-option transaction of 500 contracts or more also was exempt from trade-through liability due to the application of the current linkage plan's block exception. That remains the case today.[13]

As discussed in detail above, our current proposal results in a more limited exemption than what is currently in place. There will be no trade-through exemption for the options trade, and the Qualified Contingent Cross would apply only to trades of 500 contracts or more that are tied to stock. As with the CBOE's letter, SIG has not cited a single Commission rule or section of the Exchange Act that would call our proposal into question. Thus, SIG provides no valid basis for the Commission to disapprove our filing.

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For the reasons above we respectfully request that the Commission approve the proposed rule filing contemporaneously with the Exchange's proposed distributive linkage rules.

Sincerely,

Michael J. Simon
Secretary and General Counsel

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[13] SIG also is incorrect in presuming that exchange rules then – or now – require all stock-option orders to be announced to a trading crowd for price improvement. While exchanges such as ISE expose complex orders at a net price in their complex order mechanisms, as discussed above firms can "leg into" complex orders by executing the stock and options components separately. When so legging into transactions of 500 contracts or more, both legs are trade-through exempt: the stock leg through the QCT exemption and the options leg through the block exemption.