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October 7, 2009

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Chicago Board Options Exchange ("CBOE") Petition for Review of SR-ISE-2009-35, Securities Exchange Release No. 60584 (the "Petition")

Dear Ms. Murphy:

I. Introduction

LiquidPoint, LLC ("LiquidPoint")[1] appreciates the opportunity to comment on the Petition pursuant to which CBOE seeks reconsideration by the Securities and Exchange Commission (the "Commission") of the approval by the Commission staff of International Securities Exchange ("ISE") rule filing SR-ISE-2009-35. The approval by the staff permits ISE to adopt a new rule permitting the crossing of option orders called the Qualified Contingent Cross ("QCC"), without prior exposure of the matched orders to the market or to interaction with customer orders.

[1] LiquidPoint, a wholly owned subsidiary of BNY ConvergEx Group, LLC, specializes in providing derivatives technology and execution solutions for U.S. listed options traders, including institutional customers and other broker-dealers. LiquidPoint provides electronic direct market access to every U.S. options exchange, as well as advanced trading capabilities that include order execution, order management, order routing and optimization, quality assurance review, and a variety of reporting and books and records capabilities. ConvergEx Group is a premier provider of investment technology solutions and global agency brokerage services to institutional clients worldwide. Our three key business lines – investment technologies, liquidity and execution management, and intermediary and clearing services – specialize in providing a full array of leading technologies and an integrated platform of performance driven, global trading capabilities supported by a culture of extraordinary client service.

The QCC is a significant departure from long-established rules of options exchanges, Commission policies regarding options trading, and the bedrock principles relied on by all participants in the U.S. options markets. LiquidPoint strongly supports the Petition and agrees that the Commission should set aside the staff's approval of the QCC rulemaking. The Qualified Contingent Cross will do significant harm to the integrity of the listed-options markets.

The Commission should set aside the QCC rulemaking for the reasons articulated by CBOE in the Petition. In this supporting letter, LiquidPoint wishes to highlight in some additional detail a few of the points made by CBOE in its Petition. In particular:

- The QCC rulemaking approval endorses far-reaching changes to bedrock options industry rules and principles requiring the exposure of all orders to public interaction in order to enhance price discovery and competition. The ISE has not sufficiently justified the need for these changes or explained these impacts. (*See* Section II below);

- The QCC creates a de facto "trade reporting facility", which further undermines effective price discovery, competition and transparency in the listed options markets. (*See* Section III below);

- The QCC creates a new trading model for listed option execution and clearing that is fundamentally detrimental to the quote-driven nature of options markets. (*See* Section IV below)

Accordingly, LiquidPoint recommends that the Commission review the staff's approval of SR-ISE-2009-35 as requested in the Petition and disallow in its entirety the proposed Qualified Contingent Cross rulemaking.

II. <u>QCC brings far-reaching changes to industry principles and practices</u>

The listed-options industry has from its inception embraced as a core principle the requirement of exposure on the exchange of all orders. This principle is evidenced by the rules adopted by all options exchanges and has been endorsed by the Commission during the rule-making process. Simply stated, this principle requires all orders to be subjected to competition before execution. These rules apply (with only very limited exceptions) to orders regardless of how simple or complex the options trading strategy behind the order, including proposed cross transactions. No options market participant can execute a privately negotiated cross trade without exposing both the seller's order and the buyer's order in the public market place. Every cross is subject to being rejected or broken up, in whole or in part. The exposure rules promote the important principles of price discovery, transparency, competition and accountability.

There are a number of reasons why exposure of all orders is vital to the functioning of the listed options markets. Chief among these are access to liquidity and dissemination of information. In listed options trading, there are frequently dozens of options series associated with each underlying stock. So many options securities are created for each stock to allow the trading strategies associated with the underlying stock that creates tailored risk characteristics. For example, different participants utilize options to achieve different goals. Some utilize them to hedge their exposure to cash equities. Others have sophisticated volatility trading strategies. Still others simply react to perceived miss-pricings in the marketplace. There are many other possibilities.

The result is dozens of options securities on each underlying stock. These options securities vary in terms of time, strike price, premium, volatility, put versus call, and other features. Appropriately pricing all of these securities requires maximum market information. Supporting trading in all of them requires liquidity. Exposure serves both these vital needs, because it fuels the quote-driven nature of options markets.

In order for each of the multiple options series to exist, options market makers must provide quotes for all of them. These professional options traders take risk every day by posting quotes on the each of the dozens of options securities associated with each underlying stock. Without the exposure rule, the market would be deprived of a vital source of liquidity and price discovery, thereby undercutting the market makers' function. By some estimates, market makers in the options markets account for over 80% of available liquidity. If the market makers flee, liquidity would dry up and the ability of options market participants to execute their myriad strategies would disappear.[2]

The QCC allows transactions to be privately negotiated and consummated without prior dissemination of all terms and conditions for competitive responses. This private negotiation and execution precludes transparency for other market participants. Price discovery and accountability are impaired without the competition of market participants being given an opportunity to respond. Not only will liquidity vanish from the market, but

[2] These characteristics stand in sharp contrast to the cash equities markets, where customer orders create a substantial share of available liquidity due to the fact that only one security trades for each stock (i.e., the stock itself). It is important when considering the CBOE Petition to focus on the differences between the options markets and the stock markets. The simple fact of off-exchange (or "dark") trading is not what makes the QCC proposal problematic. It is the differences inherent in trading options, as discussed herein that make the QCC problematic.

the lack of best execution accountability associated with the QCC will inhibit Commission and SRO efforts for responsible regulation.

Because the staff's approval did not give sufficient consideration to the issues, resulting in a decision based clearly on erroneous facts, these far-reaching changes require the Commission to review the approval of SR-ISE-2009-35 as requested by the CBOE. For a matter of such significance, it is imperative that the Commission itself evaluate and address it.

III. QCC creates a de facto "trade reporting facility" undermining effective price discovery

Price discovery for the effective transfer of risk via the derivative markets is an essential function of the model for listed options trading. The listed-option markets rely heavily upon full disclosure of every potential transaction in order to accurately price risks. Accurate pricing in listed options must take account of many more data points than is the case in stock markets. For example, the stock markets do not price securities by reference to strike price, volatility, time to maturity, or reference to an underlying security's prices. These are all important to the options trader; as is the interrelationship of these features across different options series on the same underlying stock. Thus, the more information that is available, the greater the chance that all parties to a trade will receive fair pricing. Subjecting orders to the competition of open market exposure yields the most important kind of information in the greatest quantity.

Allowing off-exchange private price negotiations will create the opportunity for a party to reap a relative pricing advantage at the expense of other participants. This unfair advantage will increase the economic gain of a few at the expense of the many; ultimately increasing the market-wide costs to transfer risk. Throughout the recent financial crisis, the current listed-option price discovery methods effectively allowed risk transfer at a fully competitive cost. QCC undercuts this important function.[3]

And what would happen if ISE decides to give out that information, but on a selective basis?

[3] Also unlike dark pool trading on the stock side of the marketplace, the QCC does not mandate a price at or within the NBBO, resulting in significant disadvantage to one party, and misinformation to the marketplace.

IV. QCC creates a new trading model that is fundamentally detrimental to the quote-driven nature of derivative markets.

As a derivatives market, listed options trading is fundamentally dependent upon competitive quoting. For each underlying security, multiple options exist with quantifiable pricing and risk relationships. Investors may tailor the risks associated with the underlying security to meet their needs. Continuous quoting has proven to be necessary to assess the most cost efficient means of mitigating risk; that is to say, arriving at a price that fairly reflects all of the factors inherent in pricing an option. Without continuous quoting supplied by different market makers assessing pricing differently, the options markets would arrive at prices less accurately and less efficiently, because of the large number of factors associated with pricing options.

The QCC, as a de facto trade reporting facility with hidden trades and quotes, creates a disincentive for continuous quoting by options market makers. As price discovery moves off-exchange, the quoting liquidity provider will receive less information about prices and less opportunity to trade, making him more likely to only trade at levels worse than the off-exchange participant. As profit seeking businesses, these liquidity providers will migrate off-exchange where greater margins may be available with less competition, causing a decrease in quoting and the fragmentation of both pricing and liquidity. Ironically, reduced exchange quoting will impair off-floor price discovery.

The cumulative effect of fragmented pricing and liquidity will increase the costs and decrease the availability of proven, effective risk management through derivatives.

V. Conclusion

The CBOE in the Petition makes the case (in the "Applicable Legal Requirements" section) that **all** criteria for review are met. LiquidPoint agrees and wishes to emphasize that the Staff Approval Order acknowledges that the QCC rulemaking represents "a change in certain long-standing held principles in the option market because it would permit the execution of cross orders without requiring exposure or customer priority". Such an acknowledgement in and of itself meets the standard that Commission review is needed because the "decision embodies…an exercise of discretion or decision of law or policy that is important and that the commission should review".

The CBOE in the Petition analyzes many aspects of the QCC rulemaking approval that are inconsistent with the principles and policies held by the options industry and the Commission. The aspects analyzed include; guaranteed entitlement, crossing without marketplace exposure, crossing without yielding to resting customer interest. But it is the result of these dramatic changes – a de facto trade reporting facility with hidden quotes – that is the greatest threat to the public markets. The use of the QCC allows the ISE to act as a trade reporting facility that will promote off-exchange private price negotiations, limiting price discovery and shifting the economics for all participants. This will gut the competitive, quote driven market structure fundamental to accurate options pricing (due to multiple, related options contracts) that produces the effective risk management available from options, proven during the difficult times of the recent financial crisis. The likely result will be increased costs for risk transference, increased difficulty for responsible regulation, and decreased public confidence in execution quality.

LiquidPoint wishes to emphasize that the risk management nature of the option product makes continuous quoting a proven requirement of the option marketplace and allowing the use of concepts (such as trade reporting facilities) from equity markets to make policy is illogical and will seriously harm this important tool for investors in the equity markets. LiquidPoint strongly believes that the Commission should set aside the delegated authority approval and institute disapproval proceedings.

Sincerely,

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Anthony J. Saliba
Chief Executive Officer
LiquidPoint, LLC