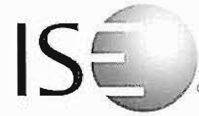

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August 25, 2010

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-2009-73

Dear Ms. Murphy:

For over 14 months the International Securities Exchange, LLC ("ISE") has been working with the Commission and its staff to adopt a Qualified Contingent Cross ("QCC") Order. Most recently, we submitted the above-referenced rule filing ("QCC Filing") proposing a modified QCC that addresses two of the major concerns that commentators had raised with our original QCC proposal.[1] The Commission received five comment letters in response to the QCC Filing.[2] The comment letters generally rehashed irrelevant arguments against the QCC. The only new arguments are of the "kitchen sink" variety – throwing everything including the "flash crash" at the proposal.

The comment letters are simply the latest attempts by our competitors to delay the ability of the ISE to offer a competitive trading vehicle for large stock-option orders. Three letters are from competing exchange organizations that operate four floor-based trading systems used to cross large orders. The other two letters are from broker-dealers closely aligned with one of those exchanges, the CBOE. These commentators have been successful in delaying QCC for over a year. Yet their arguments continue to be meritless. We urge the Commission to put an end to these delaying tactics and to approve the QCC Filing as quickly as possible.

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[1] With respect to that filing, *see* File No. SR-ISE-2009-35 (the "Original Filing").

[2] Letter dated July 30, 2010 from Anthony Saliba, Chief Executive Officer, LiquidPoint, LLC ("LiquidPoint"), to Elizabeth Murphy, Secretary, Commission; letter dated August 9, 2010 from Ben Londergan and John Gilmartin, Co-CEOs, Group One LP ("Group One"), to Elizabeth Murphy, Secretary, Commission; letter dated August 9, 2010 from Janet Kissane, Corporate Secretary, NYSE Euronext ("NYSE"), to Elizabeth Murphy, Secretary, Commission; letter dated August 9, 2010 from William J. Brodsky, Chairman and Chief Executive Officer, Chicago Board Options Exchange, Inc. ("CBOE"), to Elizabeth Murphy, Secretary, Commission; and letter dated August 13, 2010 from Thomas Wittman, President, NASDAQ OMX PHLX, Inc. ("Phlx"), to Elizabeth Murphy, Secretary, Commission.

In our Original Filing and our many letters relating to that filing (all of which we incorporate herein by reference), we explained in great detail the purpose of the QCC and how it was consistent with the Securities Exchange Act of 1934, as amended ("Exchange Act"). Simply, it is a way for ISE to compete against exchanges with trading floors by providing members with the ability to effect large stock-option orders in an all-electronic environment. Floor-based exchanges oppose the QCC because it would break the lock that they currently have on executing these trades.

The QCC Filing addressed two issues commentators previously had raised: that a member could execute a QCC at a price equal to the price of a customer limit order on the book; and that QCC somehow was a "slippery slope" to removing transparency and liquidity from exchange markets. We addressed those concerns by prohibiting the execution of a QCC ahead of a customer limit order on the ISE book at the same price and by doubling the minimum size of the QCC from 500 to 1,000 contracts. Below we note each argument the commentators now raise, as well as our response to each:

- Exposure/Transparency: A continuing theme of the objections to QCC is that it does not provide for exposure of the order and therefore inhibits order transparency. The commentators continually point to the rules of floor-based exchanges which nominally require exposure of orders to the crowd. By arguing about the theoretical benefits of exposure they ignore the realities of what is occurring in their markets. They purposely do so to preserve their lock on the large crossing business.

  As we have previously explained, members arrange large stock-option trades upstairs and then bring them to an exchange for execution. Floors accommodate these trades by providing a market structure in which there is little or no chance that members will break up the pre-arranged trade. While CBOE, NYSE and Phlx proclaim the sanctity of order exposure, in practice they do the exact opposite: These exchanges are in a competition with each other to perfect a market structure in which members can execute their trades with – using their own term – the least amount of "friction."

  If the floor-based exchanges were serious about order exposure they actually would expose large orders to their entire marketplace. They do not. Rather, while these so-called "hybrid" markets integrate most aspects of their floor-based and electronic systems, they limit exposure of crossing orders to those few (if any) members physically present in the floor-based trading crowd for an option. They also impose fees to discourage competition for orders crossed on the floor.[3] Ironically, CBOE (not NYSE) cites a recent NYSE Arca

[3] *See* letter dated August 13, 2010 from Michael Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission, regarding File No. SR-BX-2010-49 and similar fees of the CBOE and Phlx.

filing on floor-based crossing as evidence that floors are not "frictionless."[4] CBOE seems to be arguing that since the floor-based exchanges continue to degrade the process for executing solicited trades, there must be similar levels of friction on the floors as on electronic exchanges.

The CBOE comment confuses two levels of competition. First, there is competition among the floor-based exchanges that currently have a lock on the execution of large-size crossing transactions because they all offer trading environments with minimum friction. The competition among these exchanges is to reduce even further the current minimal level of friction. Second, there are electronic exchanges that seek to compete in this business, but have little success since they are on the opposite end of the spectrum in terms of market "friction." Thus, the NYSE Arca proposal has nothing to do with competing with the ISE because the electronic exchanges are not even in the game. And that is precisely why the floor-based exchanges are fighting so hard against our QCC proposal.

As we have explained in all our QCC submissions, we simply seek to provide a competitive and efficient method to compete against the floor-based exchanges. The floor-based exchanges – and those who benefit from trading on them – will raise any and all issues to try to confuse the facts in an attempt to allow them to maintain their control of the crossing business.

- Price Improvement: Tied to the transparency issue is the "price improvement" issue. The commentators argue that the failure to expose the order to the crowd denies customers the opportunity for price improvement. This is not a new argument, and we have responded to it previously. The QCC is a trade of at least 1,000 option contracts tied to stock, in which the parties negotiate a net price. As we explained a year ago in responding to these same issues:

> 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. 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.[5]

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[4] File No. SR-NYSEArca-2010-69 (the "Arca Filing") and letter dated August 17, 2010 from Michael Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission, on the Arca Filing.
[5] Letter dated August 20, 2009 from Michael Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission, responding to comments on File No. SR-ISE-2009-35.

Thus, price improvement of the individual legs of the trade is not a critical issue in executing the QCC. Much more important is the ability to execute the trade at the negotiated net price, and not miss the market in achieving that execution. The floor exchanges offer that opportunity to members and they raise false issues such as this to impede our ability to compete.

- Flash Crash and Liquidity: The rapid fall and then rise in the securities markets on May 6, 2010 has no relevance to QCC. But there have been significant regulatory concerns regarding the flash crash, and we assume that the commentators believed they could at least confuse the issue by putting the words "QCC" and "flash crash" in the same sentence. Of course, due to their delaying tactics, QCC was not operational on May 6th, and thus had no relationship to the flash crash.

  CBOE and NYSE appear to argue that QCC will remove significant liquidity from the market, potentially exacerbating flash crash-like events. The most obvious response to such a concern is to repeat what we stated above: if these commentators really believed that providing all market makers and other exchange members with an opportunity to participate in large stock-option trades was necessary for fair and orderly markets they would provide their own members with a meaningful opportunity to trade with these orders on their own exchanges. Rather, the floor-based exchanges purposely limit exposure of these orders to small or non-existent physical "crowds," refuse to disseminate the trade information to the liquidity providers in the electronic portion of their markets, impose fees to limit participation and seek to adopt new rules, like the Arca Filing, to provide even less friction on the floor.

  In attempting to tie QCC to the flash crash, the commentators again conveniently forget that large stock-option trades currently are arranged upstairs and then shopped among exchanges to achieve a clean cross. That is, large stock-option trades today rely on the liquidity that firms can provide in arranging these trades and do not now include exchange-provided liquidity. QCC will simply provide a competitive electronic vehicle for these trades and will have no effect on available liquidity.

  NYSE is particularly disingenuous is arguing that QCC will harm market liquidity. NYSE states that its market makers have an obligation to stream two-sided markets in options classes on over 1,000 securities that collectively represent over 200,000 series. They argue that they provide this liquidity, in part, because they get to participate in trades brought to the exchange. Yet *NYSE does not give these market makers – the ones "streaming" these quotes electronically – the opportunity to participate in the crosses that come to their options trading floors.* The argument that QCC will harm liquidity is totally without merit as liquidity providers present in today's electronic market cannot participate in large stock-option trades executed on the floors.

- Reach of QCC: The CBOE states that 36 percent of its volume came from orders of 1,000 or more contracts, implying that this is the potential reach QCC could have into the market. In contrast, approximately 17 percent of the ISE's volume is from orders of that size. We first note that these numbers are meaningless. Both numbers clearly overstate the extent to which QCC will affect the market since both numbers include one-sided orders, options trades that are not tied to stock, and other orders that would not be QCC-eligible. The CBOE's numbers also include trades in its exclusive products, which are only traded on the floor and which have a large institutional segment. To the extent you can take anything at all from these numbers, they likely exemplify the current competitive environment, as the CBOE is currently providing a more frictionless market for large trades and thus attracting a greater market share of large orders.

- Slippery Slope: Not content with overstating the potential reach of QCC as proposed, and despite our doubling of the minimum QCC size, a continuing theme of the comment letters on QCC is what QCC *may* lead to in the future. For example, Group One argues that QCC will be a "major turning point" as "more orders move to 'frictionless crossing.'" Phlx argues QCC "could trigger a race-to-the bottom where options markets compete to provide execution functionality and lower levels of order exposure." "Slippery slope" is a lazy objection to a proposal, as anyone can postulate about possible derivations of a proposal down the road. But it similarly is easy to dismiss such baseless objections. The Commission need only rule on the proposal before it, a proposal that applies only to orders of 1,000 or more contracts tied to stock. No exchange will be able to expand the QCC concept without specific Commission approval, thereby preventing a "slippery slope" from occurring. In fact, if there is a slope here, it is not particularly slippery, and it point upwards, not downwards. We doubled the minimum size of the QCC order from 500 to 1,000 contracts. Only the floor-based exchanges are on a slippery slope, as they continue to perpetuate the myth that there is meaningful order exposure on their bifurcated markets while proposing, as does NYSE Arca, to allow solicited crosses of all types, with no minimum size, and without any real exposure.

- Fictitious Trades: NYSE makes the incredulous argument that our members would fraudulently arrange a 1,000 contract QCC, stating "it will be very easy for those market participants engaged in private negotiations to append the required number of relatively cheap options to a trade whenever they wish to enjoy a 100% participation guarantee." Like the flash crash comment, the utter absurdity of this allegation makes a response difficult. But we will try.

  First, no one has ever alleged that exchange members inappropriately "append" worthless contracts to the many current orders with minimum size

requirements.[6] Second, any member attempting to do this would be creating fake customer orders, thus misrepresenting the order in violation our rules. While fraud is always possible, the remedy is to identify and prosecute the fraud, not to ban the underlying activity. In this regard, we are confident that our surveillance program would catch any attempt to misrepresent the size of the order. Indeed, we suspect that the entire market would notice a sudden increase in the volume of so-called worthless option contracts.

- Definition of QCC: CBOE believes that the QCC is "ill-defined," while NYSE argues that QCC is based on the Commission's "qualified contingent trade" ("QCT") exception, which it seems to believe is inappropriate.

  CBOE questions how we calculate the 1,000 contract minimum for the QCC. Nothing could be more clear in our proposed rule: proposed ISE Rule 715(j) defines QCC as "an order to buy or sell at least 1,000 contracts that is identified as being part of a qualified contingent trade...." This means what it says, that there must be an order to buy or sell 1,000 contracts that is part of a QCC – not two 500 orders, not two 500 legs, not anything but an order to buy or sell at least 1,000 contracts.

  As to NYSE's concerns with QCT, we took the definition of the term verbatim from the definition the Commission used in defining the QCT for the purposes of Rule 611 of Regulation NMS.[7] We are not aware of there being any ambiguity in the market regarding this term or in determining whether an order is "fully hedged," as required by the Commission's definition of the term. In applying the definition to the QCC, we will require that our members be in full compliance with the conditions the Commission established for the QCT.

- Ballista: CBOE continues to argue that our minority ownership in Ballista Securities somehow taints our QCC proposal. CBOE seems to imply that Ballista is engaged in some form of nefarious or illegal "grey pool" involving off-exchange trading. For the record, our small ownership in Ballista is totally unrelated to QCC. We own 8.29 percent of the firm. We have one director on the Ballista board, but have no influence on the day-to-day operation of the firm. We further believe that Ballista is fully compliant with all legal requirements. In determining where to execute its order flow, Ballista's management will make its own routing and business decisions. We deal with Ballista on a totally arms-length basis, and provide them with no special fee or other access arrangements.[8] Ballista sends order flow not just to us, but also

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[6] *See* ISE Rule 716 regarding Block Trades, the Facilitation Mechanism and the Solicited Order Mechanism.

[7] Securities Exchange Act Release No. 57620 (April 4, 2008). That release superseded a release initially granting the Qualified Contingent Trade exemption. Securities Exchange Act Release No.54389 (August 31, 2006).

[8] Contrast our arms-length relationship with Ballista with the preferred deals CBOE strikes with order-routing firms. For example, CBOE has deals with firms providing terminal services where

to the other options exchanges. Our ability to offer QCC will only provide them with an electronic alternative to the floor-based exchanges when making those order-routing decisions.

- Commission's Statistics: The CBOE Letter contains the conclusory statement that the Commission's Division of Risk, Strategy, and Financial Innovation ("RiskFin") stated that "market participation on orders is no less prevalent on trading floors than on ISE's existing market." This reiterates a point that CBOE first made when commenting on RiskFin's data.[9] However, simply repeating incorrect statements – without ever actually discussing the underlying data – does not make such statements correct. As we explained in our comment on the RiskFin data, that data showed that the percentage of order break-up on the ISE was over twice the rate as on CBOE. And as RiskFin itself noted, its data likely seriously overstated relevant break-ups on the CBOE because the data included non-QCC eligible trades, as well as trades in CBOE's exclusively-listed index options that trade only on the floor.[10] Indeed, the CBOE fails to cite any actual statistics in its letter because the numbers do not support its claims.

- Loss of the Block Exemption: We proposed the QCC in conjunction with the new "distributive" linkage plan. Because the new plan did not contain the block exemption that was in the old linkage plan, we worked with the Commission staff to develop the QCC as an alternative to that exemption. CBOE now states that "ISE actually drafted the new plan which did not contain the block exemption" and "the ISE affirmatively omitted the block exemption from the new plan." They then claim we first raised this issue when we invested in Ballista. CBOE has its history wrong.

  The new linkage plan is based on Regulation NMS for equity securities, which does not contain a block exemption. The Commission staff made clear to us that they would not support a block exemption for the parallel options plan. It was our initial position that the "complex order" exemption in the new linkage plan would be broad enough to cover stock-option trades executed in two markets. It was during the continuing discussions on the issue that the QCC proposal arose. The QCC builds upon the QCT exemption the Commission granted under Regulation NMS and is thus fully consistent with linkage concepts in both the equity and options markets.

- Proponents and Opponents of QCC: CBOE rhetorically asks: Where are the firms defending QCC? We believe that CBOE is asking the wrong question.

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order-routing is free to the CBOE but routing to other markets incurs a fee. *See* https://www.cboe.org/hybrid/hyts.aspx.

[9] Letter dated April 7, 2010 from Edward Joyce, President and Chief Operating Officer, CBOE, to Elizabeth Murphy, Secretary, Commission.

[10] Letter dated April 7, 2010 from Michael Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission, regarding File No. SR-BX-2010-49.

The right question is: Who is opposing our current QCC proposal? The answer is: the operators of the four floor-based options exchanges and two broker-dealers closely affiliated with the CBOE.[11] This is not a dispute that directly involves broker-dealer firms. As Capstone Global Markets LLC noted in its comment letter, broker-dealers can effect these trades today on floor-based exchanges and QCC simply provides another, more efficient alternative trading mechanism for them to use.[12] This is a dispute between exchanges, and broker-dealers generally have no incentive to involve themselves in such disputes. We thus end this letter where we began: the opponents of QCC are floor-based exchanges who seek to inhibit competition in the market for the execution of large stock-option trades.

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We thank the Commission for the opportunity to respond to the comment letters on our QCC proposal. The five comment letters on our current proposal do no more than reaffirm that the opponents of QCC seek only to delay our ability to offer an electronic, efficient alternative to the current floor-based lock on executing large stock-option trades. We respectfully request that the Commission approve the QCC without further delay. If the Commission or staff have any further questions on this matter, please do not hesitate to contact us.

Sincerely,

Michael J. Simon,
Secretary

cc: Hon. Mary L. Schapiro, Chairman
Hon. Luis A. Aguilar, Commissioner
Hon. Kathleen L. Casey, Commissioner
Hon. Troy A. Paredes, Commissioner
Hon. Elisse B. Walter, Commissioner
Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
Heather Seidel, Acting Associate Director, Division of Trading and Markets

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[11] Benjamin Londergan, Co-CEO of Group One is on the CBOE board of directors; CBOE and Tony Saliba of LiquidPoint have a long history of business relationships.
[12] Letter dated December 9, 2009, from Leonard Ellis, Head of Capital Markets, Capstone Global Markets LLC to Elizabeth Murphy, Secretary, Commission.