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August 24, 2010

Elizabeth Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: International Securities Exchange August 13, 2010 Letter

Dear Ms. Murphy:

This letter responds to an August 13, 2010 letter to the Securities and Exchange Commission ("Commission" or "SEC") from the International Securities Exchange, LLC ("ISE") in which ISE expresses concern over certain fees in place at several options exchanges including Chicago Board Options Exchange, Incorporated ("CBOE"). As discussed below, ISE's comments about CBOE's fee structure are completely baseless. Indeed, on several fronts the ISE engages in the very conduct it complains about. We can only surmise that ISE is attempting to improve its competitive footing by submitting and publicizing unfounded regulatory complaints. Regardless of motive, we look to the Commission to carefully assess not only the substance of ISE's complaints, but to also assess the appropriateness of the very serious and damaging public accusations made by ISE regarding CBOE and other exchanges.

Summary of ISE's "Complaint"

ISE generally claims that other exchanges are using fees to create disincentives for market makers to price improve and/or participate in trades that firms seek to internalize. Embedded in that claim is the notion that customers and the marketplace benefit when price improvement and market maker participation occur. We agree with the underlying premise that internalization without exposure and market maker participation is harmful to the marketplace. It is difficult, however, to reconcile ISE's purported commitment to that premise, given ISE's history of introducing internalization methods that seek to minimize market participation, and given that ISE now seeks to adopt a new mechanism, the Qualified Contingent Cross ("QCC"), which bypasses exposure to the marketplace altogether.

Much of ISE's letter is dedicated to criticizing certain Boston Options Exchange fees, and we will refrain from commenting on that dispute. We will restrict our comments to those portions of the letter that concern CBOE, beginning with ISE's blatant mischaracterization of CBOE's marketing fee as a break-up tax meant to reduce CBOE market maker participation on cross trades submitted to CBOE's Automated Improvement Mechanism ("AIM").[1]

Clarifying CBOE Fees and AIM

For many years CBOE has had in place a marketing fee whereby a charge is assessed against CBOE market makers when they trade against customer orders. The monies collected through this charge are pooled so that CBOE DPMs and market makers may distribute the funds to order-sending firms (this practice, which can be structured in different ways and administered by exchanges and/or market making firms, is called payment for order flow). As part of an AIM auction, exposed customer orders frequently trade against market maker responses and the marketing fee is applied in those situations. Importantly, the fee amount is the same as any other instance where CBOE market makers trade against customer orders (the amount of the fee may differ from option class to option class, but it does not differ based on the mechanism or scenario that caused the trade). In fact, the marketing fee predates the existence of AIM. Thus, it is nonsensical to assert that CBOE's longstanding marketing fee program is structured to stop market makers from participating on AIM trades.

As part of ISE's attack on AIM, ISE claims that "trades are rarely broken-up on the CBOE" and that on ISE these trades "are routinely broken up." Both statements are false. The Commission may verify for itself the speciousness of the first claim through the AIM-specific regulatory reports it receives from CBOE which include data related to market maker participation on AIM trades. As to the second claim, as we have discussed in great detail in our various submissions on the ISE QCC proposal, an "options ATS" partially owned by ISE had, for months, posted statistics on its website highlighting the very low break-up rate experienced on ISE in connection with crosses submitted from the ATS firm.[2] We can only guess what motives are at play in ISE's attempt to disparage CBOE's longstanding fee structure and AIM process, especially when considering that ISE appears to engage in very the conduct it complains about.

Applying ISE's Expressed Concerns to its Own Fees and Proposals

A key aspect of ISE's complaint in its letter is that fees paid by internalizing firms are less than fees paid by participating market makers. ISE surmises that the SEC has

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[1] ISE has a mechanism substantially similar to AIM called PIM. ISE also has several other crossing mechanisms including ISE's Facilitation Mechanism, Solicitation Mechanism, and Directed Order Mechanism.

[2] To read comments from CBOE and other market participants explaining the harmful effects of ISE's ill-advised QCC proposal, see http://www.sec.gov/rules/other/2009/sr-ise-2009-35/ise200935_statements.shtml, http://www.sec.gov/comments/sr-ise-2010-73/ise201073.shtml and http://www.sec.gov/comments/sr-ise-2009-35/ise200935.shtml#order.

established a $0.02 per contract cap on the permissible fee differential when dealing with captive order flow. Given the vigor with which ISE claims that exceeding the $0.02 threshold is inconsistent with the Securities Exchange Act of 1934, it is (somewhat) surprising that a quick review of ISE's fee schedule shows that ISE itself exceeds this threshold. Specifically, for ISE PIM trades in which an internalizing firm seeks to trade against a customer order, the internalizing firm is charged $0.20 per executed contract, AND is rebated $0.15 cents per unexecuted contract. An ISE market maker participating in a PIM trade is charged a fee per executed contract but is not rebated for unexecuted contracts. The market maker fee amount is dependent on the discount tier the market maker falls into. For example, the entry tier results in an $0.18 per contract fee, the next tier results in a $0.16 per contract fee.

Suppose a PIM auction takes place where a firm seeks to internalize a 100 contract order. At the conclusion of the auction, the firm internalizes 50 contracts and a market maker falling within the $0.16 tier participates on the other 50 contracts of the order. The market maker will be charged $0.16 per contract. The firm, on the other hand, after the $0.15 per contract rebate is applied on the 50 contracts it did NOT trade, will be charged $0.05 per contract. The $0.11 disparity between what those two participants pay seems to exceed the $0.02 standard referenced by the ISE. Thus, by ISE's logic, ISE's fees are not in compliance with Exchange Act requirements.

ISE also claims that "the Commission has sanctioned the use of crossing or internalization vehicles in the options market for two reasons, to encourage exchange members either: (i) to add liquidity to help execute large, institutional orders; or (ii) to provide price improvement for small customer orders." While we cannot find Commission statements that support this ISE assertion, we can't help but point out that the assertion conflicts with ISE's pending QCC proposal which would allow unfettered crossing without any exposure to the marketplace. QCC trades do not seek to add liquidity and certainly do not allow for price improvement. We also note that only in recent years did the SEC even allow crossing mechanisms to handle small orders (*i.e.* under 50 contracts), so it would be more appropriate to state that allowing for price improvement for *all* orders subject to internalization is something the Commission encourages, but ISE won't go that far because that is something QCC fails to allow.

Further, we remind the Commission that ISE is the exchange that built functionality on its user interface to facilitate the rapid fire submission of AON orders that were not visible to any ISE members to facilitate crossing those orders without interference (not exactly consistent with ISE's stated dedication to market maker participation). Ultimately, the Commission intervened in that instance and required ISE to make AON information available to members to add transparency and a semblance of fairness to the offering. ISE, thus, again complains about other exchanges in connection with a supposed SEC standard that ISE itself disregards.

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Competition between the various options markets is at an all-time high. However, recklessly hurling unfounded regulatory accusations against competitors is slanderous. It is a dangerous precedent, and we hope the Commission takes appropriate action. Please contact me at 312-786-7310, Joanne Moffic-Silver, General Counsel & Corporate Secretary, at (312) 786-7462 or Angelo Evangelou, Assistant General Counsel, at (312) 786-7464 if you have any questions regarding this letter.

Sincerely,

Edward J. Joyce

cc: **Robert W. Cook**, Division of Trading and Markets
James A. Brigagliano, Division of Trading and Markets
Heather Seidel, Division of Trading and Markets