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August 22, 2011

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

Re: File Nos. SR-BX-2011-046 (Release No. 34-64981)

Dear Ms. Murphy:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the above-referenced rule filing (the "Fee Change") of the Boston Options Exchange ("BOX") regarding discriminatory fees BOX charges with respect to its Price Improvement Period ("PIP"). Because the Fee Change imposes a substantial burden on competition to the detriment of retail investors, we urge you to suspend the effectiveness of the Fee Change and to initiate disapproval proceedings.

Overview

Box's PIP is a vehicle for broker-dealers to internalize small order flow by agreeing to improve the price of a customer order by at least one cent above BOX's current bid or offer, provided that the execution at least equals the national best bid or offer ("NBBO"). The PIP initiator (or "internalizer") must expose the order to other BOX participants to give them an opportunity to compete for the orders. After the order is exposed, the PIP guarantees the internalizer 40% of the customer order if there are competing participants at the same price. However, an internalizer may execute a much smaller percentage of the customer order if competing market participants offer a higher level of price improvement. This process, which is similar among the options exchanges that offer price improvement mechanisms, represents a balancing of interests by providing an incentive (the execution guarantee) for market participants to provide price improvement to customer orders, while assuring there is adequate opportunity for other market participants to provide competitive prices.

The competitive process contemplated by the PIP rule protects the retail customer by assuring that they receive the best possible prices. However, as discussed below, the BOX fee structure serves to contravene the competitive design of the PIP by making it economically prohibitive for any member to provide competitive prices for customer orders in the PIP.

Discriminatory Fee Differential

The Fee Change results in BOX imposing far lower fees on internalizers than those imposed on BOX market participants that seek to compete for orders entered into the PIP. When BOX established this anti-competitive fee structure in August 2010, we raised concern that the differential between the fees charged internalizers and the fees charged all other market participants (the "fee differential") was designed to circumvent competition in the PIP.[1] At that time, the BOX fee/credit for the PIP was $.25, which resulted in a fee differential between $0.25 and $0.40. BOX raised the fee/credit for PIP to $0.30 in April 2011.

Under the Fee Change, fees charged BOX market participants that respond to a PIP order will increase from $0.30 to $0.75.[2] When added to the $0.25 transaction fee, such market participants will be charged a total fee of $1.00 per contract, which is equal to an entire penny on the quoted price of an options contract.[3] In contrast, when the internalizer executes a PIP order, the $0.75 credit and debit are both paid and received by the internalizer. Thus, the order internalizer only will be charged a transaction fee that ranges between $0.10 to $0.25 per contract (depending on certain volume thresholds). As a result, the fee differential is now between $0.75 and $0.90.

BOX asserts that the Fee Change provides for the equitable allocation of reasonable dues, fees, and other charges among its members because the fees and credits apply uniformly to all categories of participants and across all account types in the PIP. As discussed above, this is a disingenuous statement, as the application of the fees and credits most certainly do not have a uniform application across all members. BOX does not identify the fee differential that is created by the Fee Change nor does it discuss how such discrimination among members is consistent with the Exchange Act. This is a material omission from the filing, and absent a justification as to how the Fee Change complies with the Exchange Act, the Commission must suspend the effectiveness of the proposal and begin disapproval proceedings.

Impact on Competition and Investors

Since BOX does not even acknowledge the fee differential, there is no discussion of its impact on competition for orders entered into the PIP. Rather, BOX asserts that "it is appropriate to provide incentives to market participants to use PIP, resulting in potential benefit to customers through potential price improvement." This is the lynchpin of BOX's support for the Fee Change, and is erroneous in two respects. First, it assumes that customers automatically benefit if their orders are entered into the PIP, which is not necessarily the case. A BOX member can enter an order into PIP to

[1] The BOX first adopted the fee structure in August 2010. SR-BX-2010-49. The ISE submitted a comment letter on that filing regarding its concerns with the anti-competitive fee structure. Letter from Michael J. Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission, dated August 13, 2010 (attached hereto as Exhibit 1).

[2] The Fee Change applies to PIP transactions in non-penny classes and in penny classes where the trade price is at least $3.00.

[3] Options are quoted as a price per share, and one contract generally represents 100 shares of stock. Therefore, each $0.01 increment equals one dollar per contract ($0.01 x 100 shares).

provide an execution at a price that only matches the national best bid or offer ("NBBO") when the BOX best bid or offer is not equal to the NBBO. Second, it does not take into consideration that the incentive being provided will itself degrade the quality of the execution received by the customer, as the fee differential will place an insurmountable economic burden on any market participant seeking to compete with an order internalizer in the PIP. The following examples illustrate these two points:

- Assume the NBBO is $4.00 x $4.01, and the BOX best bid is $3.99. The internalizer enters a customer order to sell 5 contracts at $4.00. Any competing market participant will pay a fee of $1.00 per contract to participate and trade against the customer order at $4.00. Therefore, to improve the internalizer's price by one minimum trading increment ($0.01) to $4.01, it must be willing pay $2.00 ($1 per contract in fees and $0.01x100 in option premium) more, or the equivalent of paying $4.02 for the order. Since it is highly unlikely that any market participant will be willing to pay $4.02 for the order when the national best offer is $4.01, the internalizer executes the entire 5 contracts at $4.00, and the customer receives no price improvement over the NBBO.[4]

- Assume the NBBO is $4.00 x $4.02. The internalizer enters a customer order to sell 5 contracts at $4.01. Any competing market participant will pay a fee of $1.00 per contract. Therefore, to improve the internalizer's price by one minimum trading increment ($0.01), it must be willing pay $2.00 more, or the equivalent of paying $4.03 for the order. Since it is highly unlikely that any market participant will be willing to pay $4.03 for the order when the national best offer is $4.02, the internalizer executes the entire 5 contracts at $4.01. While the customer receives $0.01 in price improvement, the internalizing member essentially was given a 100% execution guarantee that eliminated the opportunity for the customer to receive $0.02 in price improvement.

- In both examples above, even if there is a market participant willing to pay $0.02 more than the internalizer's price, the customer only receives $0.01 in price improvement. Where does the other $0.01 go? Three-quarters of it, almost a full price increment ($0.75 per contract) goes to the internalizer. Thus, the credit received by the internalizer comes out of the pocket of its own customer that might otherwise have received a higher rate of price improvement.

As demonstrated above, the Fee Change will all but assure that internalizers are able to execute against their customer orders without competition. While the Commission could conclude that increasing the execution guarantee generally applied by all exchanges that offer price improvement mechanisms above 40% is appropriate after weighing the potential benefits to investors and the potential impact on price competition, we do not believe a 100% guarantee would pass such scrutiny. In any event, no such analysis has been conducted with respect to the Fee Change's impact on execution guarantees.

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[4] To simply join the current price, without further price improvement, the competing market participant pays a total of $1.00 per contract while the initiator pays between $0.10 and $0.25.

If the Commission is prepared to allow increases in execution guarantees to internalizers on the options exchanges, it should do so directly and in a manner that preserves competitive pricing so that investors receive the best possible price – not by allowing the options exchanges to create economic barriers that prevent competitive pricing altogether. As demonstrated by the examples above, we believe such a race to the bottom comes at the expense of retail investors who are denied the opportunity to receive the best possible prices for their orders.[5]

Competition Among Exchanges

BOX asserts that competition among markets justifies the Fee Change. In the filing, BOX makes the following statements:

> "[T]he proposed change will allow the fees charged on BOX to remain competitive with other exchanges . . . . The Exchange believes that the PIP transaction fees and credits it assesses are fair and reasonable and must be competitive with fees and credits in place on other exchanges. Further, the Exchange believes that this competitive marketplace impacts the fees and credits present on BOX today and influences the proposal set forth above."

These statements are vague and unsupported in the filing. There is no comparative analysis of exchange fees contained in the filing to support the assertion that the Fee Change is necessary to be competitive with fees and credits in place on other exchanges. In fact, we do not believe that any of the existing fees on the other options exchanges results in fee differentials between order internalizers and other market participants anywhere near the $0.90 differential imposed by the Fee Change. Given that the filing does not even identify the fee differential created by the Fee Change, it is impossible to even determine to what fees and credits BOX is comparing the Fee Change.

The Fee Change is not about price competition among exchanges at all. It is an attempt to accommodate those market participants that seek greater opportunity to internalize order flow on the options exchanges. As BOX explains in the filing, it will not realize revenue from the Fee Change because it pays the credit to the internalizer at the same rate as the fee. This is the fundamental issue the Commission must confront: the purpose of the Fee Change is not to provide for the equitable allocation of reasonable dues, fees and other charges among BOX members. As discussed above, BOX imposes separate execution fees from which it receives revenue. Rather, BOX is

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[5] A lack of competition will result in customers receiving a lower amount of price improvement, as internalizers have no incentive to offer more than the minimum amount of price-improvement. While the information is confidential, we believe that an analysis of the PIP data reports BOX provides the Commission on a monthly basis would show that the average amount of price improvement received by customers in the PIP has declined since the fee differential was first introduced in 2010. Indeed, the Commission has received a separate comment letter on the Fee Change showing this to be the case based on publically available data published on the BOX website. Letter from John C. Nagel, Citadel Securities LLC, to Elizabeth M. Murphy, SEC, dated August 12, 2011.

seeking to offer an execution venue that is designed to guarantee internalizers more than the 40% provided in its rules by using fees to discourage competition in the PIP.

* * *

The Commission should not allow BOX to circumvent the exposure of customers orders in the PIP by imposing fees that make it economically impracticable for other market participants to compete with order internalizers. As discussed above, the filing does not provide an adequate basis for determining that the Fee Change is consistent with the Exchange Act, as it fails to (i) identify and address the pricing differential of up to $0.90 for BOX market participants that seek to compete with internalizers; (ii) identify and address the burden on competition evident from the current discriminatory pricing BOX seeks to increase; and (iii) provide support for its assertions regarding competitive pricing among exchanges. Accordingly, we urge the Commission to suspend the effectiveness of the Fee Change and to initiate disapproval proceedings.

If you have any questions on our comments, please do not hesitate to contact us.

Sincerely,

Michael J. Simon
Secretary

cc: 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

Exhibit 1

INTERNATIONAL SECURITIES EXCHANGE.

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August 13, 2010

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

Re: File Nos. SR-BX-2010-49 and File No. S7-09-10

Dear Ms. Murphy:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the above-referenced rule filing of the Boston Options Exchange ("BOX") regarding anticompetitive and discriminatory fees BOX charges with respect to its Price Improvement Period ("PIP"). Because we also have concerns with other exchanges' rules that have similar anticompetitive effects, we submit this comment letter in response to the Commission's request for comment on various options fee-related issues.[1]

Overall, we believe that an increasing number of existing and proposed fees from various options exchanges inappropriately impede competition for order flow by "stacking the deck" in favor of firms that seek to trade against – or "internalize" – their retail customer order flow. These rules include: BOX's current proposal; the manner in which the Chicago Board Options Exchange ("CBOE") imposes payment for order flow ("PFOF") fees; and the NASDAQ OMX PHLX's ("Phlx") floor fees. As discussed below, the Commission has rejected discriminatory fees of greater than $.02 that encourage internalization. The BOX, CBOE and Phlx fees clearly violate that standard. We urge you to suspend the effectiveness of the BOX rule filing[2] and to expand your current rulemaking proceedings regarding options fees to address the CBOE and Phlx fees.

I. BOX's Proposed Fee Change Discourages Competition for Order Flow

PIP is a vehicle for a broker-dealer to internalize its small order flow by agreeing to improve the price of a customer order by at least one cent above BOX's current bid or offer, provided that the execution at least equals the national best bid or offer ("NBBO"). The PIP initiator must expose the order and, in theory, can lose some or all of the order to other exchange members that respond to the PIP broadcast. However, BOX's new fees help ensure that its members will be able to use the PIP to internalize small orders at the NBBO, with no real opportunity for customers to receive price improvement.

[1] Release No. 61902, April 14, 2010 (75 F.R. 20738, April 20, 2010) (the "Fee Release"). This submission is in addition to our original comment letter on the Fee Release, Letter from Michael J. Simon, Secretary, ISE, to Elizabeth Murphy, Secretary, Commission, dated June 21, 2010.
[2] *See* newly-revised section 19(b)(3)(A) of the Securities Exchange Act of 1934, as amended ("Exchange Act").

Specifically, BOX's new PIP fees make it economically prohibitive for any member to compete for the small customer orders in the PIP. As of July 19th BOX's PIP fees are as follows (all fees per contract)[3]:

- Public customers: free when taking liquidity; $.25 when providing liquidity as a PIP initiator; $.15 when providing liquidity/responding to a PIP;

- Broker-dealers initiating PIPs: a tiered fee of between $.10 and $.25;

- Broker-dealers and market makers providing liquidity/responding to a PIP: $.25;

- In all cases there is an **additional** fee/credit of $.25, with a credit for removing liquidity and a fee for providing liquidity.

In the aggregate, these fees create significant disincentives for anyone to respond to a PIP broadcast. The PIP initiator pays between $.10 and $.25 as the base fee.[4] To the extent the initiator trades against the order, the liquidity fee/credit washes out since the initiating firm pays and receives the fee/credit. Thus, the $.10 - $.25 fee is the entire cost of the transaction. In contrast, all persons responding to a PIP pay $.50 a contract to the extent they trade against the order: both public customers and broker-dealers pay the $.25 base fee plus the $.25 "provide liquidity" fee. This makes it $.25 – $.40 more expensive for the PIP responder to trade compared to the PIP initiator, significantly dissuading anyone from responding to the PIP and greatly enhancing the ability of the PIP initiator to internalize the order.

BOX is actively marketing these new fees as a way to avoid the break-up of PIP orders and to internalize order flow. Indeed, at least one order router has switched its routing of these small orders from the CBOE to the BOX due to this fee change. While trades are rarely broken-up on the CBOE (for reasons discussed below), there now was even less of a chance of break-up on BOX. Many firms do not even consider sending this order flow to the ISE as these types of orders are routinely broken up.

BOX's fee differential creates an economic barrier to order interaction and promotes internalization or trading against captive retail order flow. The BOX filing fails to explain how these fees are in compliance with the requirements of the Securities Exchange Act of 1934 ("Exchange Act") as being reasonable and non-discriminatory.[5] In this regard, the Commission has clearly established the precedent that only a de minimis fee differential is permitted when dealing with captive order flow. Specifically, the Commission has abrogated a $.05 fee differential in an analogous situation regarding directed orders, when the Phlx adopted a fee where firms to whom orders are

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[3] We have difficulty following the specific fee changes in the rule proposal itself. Accordingly, we base our comments on Informational Circular IC-2010-04, dated July 16, 2010, which BOX issued contemporaneously with the filing, and which explains the application of the new fees.
[4] BOX's sliding fee scale applies in PIP only to orders initiating a PIP, that is, seeking to internalize the order. It does not apply when responding to PIP and providing price improvement. We view this as another discriminatory application of fees intended to dissuade participation in PIP auctions.
[5] Exchange Act Sections 6(b)(4) and (5).

directed had a $.05 advantage compared to other firms trading against that order.[6] Thereafter, the Commission let stand a similar $.02 fee differential.[7] This has been the accepted norm for such fees, at least until this filing. BOX has adopted an inequitable and discriminatory fee structure contrary to the requirements of the Exchange Act.

II. The Commission Should Address Existing Exchange Fees That Similarly Impede Competition

BOX is not alone in imposing significant financial barriers dissuading members from providing liquidity to, or improving the prices of, orders that other members seek to internalize. Due to the difficulty in parsing exchange fee schedules, and the sometimes unanticipated ways that fees can impact behavior, many of these fees have been in existence for quite some time. Nevertheless, we believe that in considering the comments on the Fee Release, the Commission should take whatever regulatory action is necessary to bring such fees into compliance with Exchange Act requirements.

B. CBOE PFOF Fees

Exchanges can structure PFOF fees to be a disincentive for market makers to break up members' attempts to internalize order flow. The selective application of PFOF can result in inappropriate discrimination among members, as well as unfair competition. Such is the case with the CBOE's imposition of PFOF fees in its PIP-equivalent, its Automated Improvement Mechanism or "AIM."[8] CBOE charges market makers a $.25 per contract PFOF fee in the most active options (which are included in the penny pilot) and $.65 per contract in other options classes.[9] While the CBOE exempts certain types of transactions from the PFOF fees, such fees do apply to a market maker's transactions in AIM. ISE specifically does not impose PFOF charges for market makers responding to our similar Price Improvement Mechanism ("PIM") orders.

Based on our experience with PIM, market makers are the most likely members to respond to AIM broadcasts. It thus costs market makers $.25 more ($.65 more in non-penny names) than the initiating/internalizing firm to trade against AIM orders. The PFOF fees the market makers pay are accumulated into the pool of the market maker to whom the order was preferenced, which most likely is an affiliate of the order entry firm. The preferenced market maker then can pay the PFOF fee it received for the order back to its affiliate. The level of the fee differential, plus the subtle pass-through of the PFOF fees results in price discrimination and has an anticompetitive effect similar to the BOX's "provide liquidity" fees. Such discrimination is well above the $.02 differential the Commission has sanctioned, and we believe that this is violative of the Exchange Act.

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[6] File No. SR-Phlx-2010-14; Securities Exchange Act Release No. 61547 (February 19, 2010), 75 F.R. 8762 (February 25, 2010).
[7] Phlx rebates $.25 to directed participants for adding liquidity, while rebating only $.23 to other members. *See* http://www.nasdaqomxtrader.com/content/marketregulation/membership/phlx/feesched.pdf ("Phlx Fee Schedule"), at Section I, Rebates for and Fees for Adding and Removing Liquidity in Select Symbols.
[8] CBOE Rule 6.74A.
[9] At the most basic level, the PFOF is imposed on all orders resulting from transactions with customer orders received from firms that accept payment.

B. Phlx Floor Brokerage Fees

An even more egregious example of inequitable and discriminatory fees involves the Phlx's Facilitation Order fees. Under Phlx Rule 1064, a Phlx floor broker can bring a customer order to the floor and cross that order with a contra-side order that it holds, subject to the various requirements of the rule. One such requirement is that the broker announce the order to the crowd and include any responses to the announcement in the execution, pursuant to the terms of the rule. However, Phlx has structured its fees to punish any floor participation in the trade.

Specifically, Phlx has waived fees "for members executing facilitation orders pursuant to Exchange Rule 1604 when such members are trading for their own proprietary accounts," specifically when they seek to internalize the order flow.[10] In contrast, anyone else seeking to trade against the order is subject to a $.25 per contract "non-electronic" broker-dealer fee. Thus, a member can internalize for free, but any other member must pay $.25 a contract to participate in the order, including when such member seeks to provide price improvement. This $.25 differential is well above the $.02 differential the Commission has sanctioned, and clearly violates the Exchange Act's fee provisions.

* * *

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. The practices of BOX, CBOE and Phlx that we describe above serve neither of these purposes. The Commission can begin to address these issues by suspending the effectiveness of the BOX filing. The Commission can address the larger issues in rule making in response to comments received on the Fee Release.

We appreciate the opportunity to comment on these important market structure issues. If you have any questions on our comments, please do not hesitate to contact us.

Sincerely,

Michael J. Simon
Secretary

cc: 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

[10] Phlx Fee Schedule at Section II, Equity Options Fees, third note.