March 15, 2013

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

Re: SR-CBOE-2013-032

Dear Ms. Murphy:

The International Securities Exchange, LLC ("ISE") appreciates the opportunity to comment on the above referenced rule filing by the Chicago Board Options Exchange, Incorporated ("CBOE") in which it proposes to enter into subsidy arrangements with broker-dealers that provide order routing functionality for complex orders. In the filing, the CBOE asserts that the proposal extends its existing order routing subsidy program for regular orders to complex orders. However, the basis for, and limits placed on, the existing routing subsidy for regular orders are absent with respect to the proposed complex order subsidy. As a result, the proposed subsidy operates much differently than the existing subsidy program, and this has not been described or justified in the filing. The ISE also believes that the proposed subsidy program is improperly filed pursuant to Rule 19b-4(f)(2), as it does not establish or change a due, fee, or other charge imposed by the CBOE, and it is not limited to CBOE members. Accordingly, since the proposal is not in compliance with the filing requirements, the ISE believes it is necessary and appropriate in the public interest for the Commission to reject the rule filing or summarily suspend the rule change.

Background

The CBOE's current order routing incentive program for regular orders was first filed in 2007 for CBOE members only,[1] "clarified" in 2008,[2] and then expanded to non-member broker-dealers in 2011[3] (together the "previous subsidy filings"). As described in the previous subsidy filings, the CBOE provides a subsidy to providers of certain

[1] Securities Exchange Act Release No. 55629 (April 13, 2007), 72 FR 19992 (April 20, 2007) (SR-CBOE-2007-034).
[2] Securities Exchange Act Release No. 57498 (March 14, 2008), 73 FR 15018 (March 20, 2008) (SR-CBOE-2008-27).
[3] Securities Exchange Act Release No. 63631 (January 3, 2011), 76 FR 1203 (January 7, 2011) (SR-CBOE-2010-117).

order routing systems of $0.04 per executed contract.[4] The requirements of the existing subsidy program for regular orders are:

- The routing system must enable electronic routing of orders to all of the options exchanges.

- The routing system must provide current consolidated market data from all of the options exchanges.

- The routing system must cause the CBOE to be the default destination exchange for individually executed marketable orders if the CBOE is at the NBBO, but allow any user to manually override CBOE as the default destination on an order-by-order basis.

- The routing functionality must have a sweep function that routes the full size of the CBOE quote to the CBOE when the CBOE is at the NBBO.

- Participants must satisfy CBOE that their order routing functionality appears to be robust and reliable.

- Participants must agree that they will not be entitled to receive any other revenue for the use of its system specifically with respect to orders routed to CBOE.[5]

- Members have an obligation to consider the availability of price improvement at various markets and whether routing a customer order through a functionality that incorporates the required features allow for access to such opportunities if readily available. In this respect, members need to conduct best execution evaluations on a regular basis, at a minimum quarterly, that include its use of any router incorporating the required features.

The previous subsidy filings lack any discussion as to why the various requirements were adopted or their significance to the overall structure of the program in providing justification for the subsidy program under the Securities Exchange Act of 1934 (the "Act"). Nevertheless, it appears that the subsidy program is narrowly designed to attract marketable order flow to the CBOE when the CBOE is at the NBBO, and that the program contains protections to assure that the financial incentive to default route to the CBOE when it is at the NBBO is consistent with a broker-dealer's duty of best execution

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[4] The subsidy, which was initially $0.05 per executed contract, was reduced to $0.04 per executed contract in 2010. The program provides for a reduced subsidy of $0.03 per executed contract (initially $0.04 per executed contract) if the order routing provider elects to have CBOE perform marketing services on its behalf. Securities Exchange Act Release No. 62432 (July 1, 2010), 75 FR 39602 (July 9, 2010) (SR-CBOE-2010-66).

[5] The filings state that this requirement does not prevent the participant from charging fees (for example, a flat monthly fee) for the general use of its order routing system. Nor does it prevent participants from charging fees or commissions in accordance with its general practices with respect to transactions effected through its system.

by: (i) requiring that routing systems provide a manual override of the default routing; (ii) requiring that broker-dealers are provided consolidated market data from all of the options exchanges to allow informed routing decisions; and (iii) explicitly requiring members to conduct best execution evaluations at least quarterly. While the ISE does not necessarily agree with the conclusion, it seems likely that the Commission allowed the CBOE to provide a financial incentive to default route to CBOE "all else being equal," i.e., when the CBOE is at the same displayed best price as other exchanges and when opportunities to receive price improvement over the displayed best price is taken into consideration. It should be noted though that any attempt to manually change destinations on a transaction by transaction basis is unrealistic considering the speed at which orders are entered into the marketplace.

Complex Order Subsidy

Unlike the CBOE's existing order-routing subsidy for regular orders, the subsidy proposal for complex orders does not operate to provide a financial incentive to order routers only when "all else is equal." Because there is no consolidated market data or NBBO for complex orders, nor intermarket trade-through protection, "default routing" of complex orders means routing all complex orders to the CBOE regardless of whether the orders are marketable or whether another exchange has a better price.

Indeed, while the CBOE included the requirement that the routing functionality must allow users to manually override the default destination, it has not included the requirement that the router have the capability to route to other exchanges, nor the requirement that complex order data from other exchanges be made available to users. The CBOE merely states in this respect that these requirements "would not make sense . . . as some options exchanges do not offer complex order execution systems." This lone statement is entirely insufficient to justify a subsidy program that lacks these requirements, particularly when several other options exchanges (including ISE) do in fact offer complex order executions systems that may provide better execution opportunities generally, and on an order-by-order basis, than those available on the CBOE.[6] All such exchanges make market data for complex orders available to users. Accordingly, it would not be impracticable for the CBOE to include the requirements that a routing system qualifying for the proposed subsidy must have the capability to route to other exchanges that provide complex order execution systems, and that such systems make complex order data from those exchanges available to users.

While the CBOE states that nothing in the proposed subsidy arrangement for complex orders relieves participants from complying with their best execution obligations, the proposal does not contain the two requirements that are designed to assure market participants who use a routing system that defaults to the CBOE are able to do so. Accordingly, the proposal does not balance the financial incentive to default

[6] In fact, with ISE's legging order functionality (a/k/a implied orders) ISE by definition has a higher probability of executing a complex order then if it were sent to CBOE. See ISE Rule 715(k) and ISE Rule 722(b)(3)(ii).

route to the CBOE with the protections provided in the subsidy for regular orders. While the previous subsidy filings do not contain an analysis of the program by the Commission (since the program was filed pursuant to Rule 19b-4(f)(2)), presumably the inclusion of these two requirements was material to whether the subsidy program for regular orders was consistent with the Act when the program was established in 2007, clarified 2008, and expanded in 2011. The present filing for the complex order subsidy does not address how removing the requirements impacts the program, nor provide any analysis as to why the complex order subsidy would be consistent with the Act and a broker-dealer's duty of best execution without them.

Even if these requirements were included, however, the ISE does not believe that the proposed subsidy program for complex orders is appropriate or consistent with the Act, as it does not operate to attract marketable orders to the CBOE when all else is equal among the alternative destination exchanges. Complex orders are executed pursuant to a market structure that is completely different from the market structure that provides the underpinnings for the subsidy for regular orders (e.g., intermarket trade-through protection). The ISE does not believe that the CBOE's proposal to provide a financial incentive to default route all complex orders to the CBOE has been, or can be, justified under the Act.

The ISE also notes the filing states that participants in the program need to sign "an agreement agreeing to abide by the provisions of the program." It does not appear from the previous filings that this is a requirement under the existing subsidy program for regular orders, and the ISE questions whether there might be terms in such an agreement that should be included in the filing. In particular, the subsidy program for regular orders appears to be provided on an order-by-order basis, which makes sense in the context of a program that is designed to attract marketable orders when the CBOE is at the NBBO and "all else is equal" among potential alternative destination exchanges. There is nothing in the filings that suggests that a participant in the subsidy program for regular orders is obligated to maintain default routing for a minimum time period or for all options classes traded on the CBOE. However, this may or may not be the case with respect to complex orders since the context for the program is so different. It would be a material requirement of the complex order subsidy program if the CBOE were requiring participants to sign an agreement that made them contractually obligated to default route to the CBOE for a minimum time period or in a minimum number of options classes. Given that "default routing" of complex orders means all complex orders (i.e., not just marketable orders when the CBOE is at the NBBO as with the existing subsidy program for regular orders), such a requirement would act as an exclusivity agreement that the ISE believes would violate a broker-dealer's duty of best execution on its face.

Finally, the ISE notes that all of the filings related to the subsidy programs were submitted pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(f) thereunder. The ISE believes that this type of subsidy program is not appropriately filed under Section 19(b)(3) or Rule 19b-4(f), as it is not a due, fee or charge by the CBOE, nor is it limited to CBOE members. Given the potential market structure and best execution issues the subsidy programs present, a fuller analysis under the Act should be provided by the CBOE and the Commission pursuant to Section 19b(2).

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For the reasons discussed above, the ISE requests that the Commission reject or summarily suspend SR-CBOE-2013-032 as it fails to provide sufficient justification under the Act for establishing the proposed order-routing subsidy program for complex orders. The filing is deficient in that it fails to justify the subsidy in the context of complex orders for which there is no NBBO requirement, no intermarket trade-through protection, and no requirement to provide order routing or market data from other exchanges. The ISE also believes that the filing may be deficient if, as discussed above, all material terms of the subsidy program for complex orders are not disclosed.

Sincerely,

Michael J. Simon
Secretary

cc: John Ramsay, Acting Director, Division of Trading and Markets
James Burns, Deputy Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets