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Securities Industry and
Financial Markets Association

July 23, 2008

Via E-Mail: rule-comments@sec.gov

Ms. Florence Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Relating to Professional Account Holders (SR-ISE-2006-26; SEC Release No. 34-57254)

Dear Ms. Harmon:

The Securities Industry and Financial Markets Association ("SIFMA")[1] Equity Options Trading Committee ("Options Committee") appreciates the opportunity to comment on the proposal by the International Securities Exchange ("ISE") regarding the definition and regulation of professional account holders. SIFMA endorses the ultimate goal of the underlying rule proposal and appreciates the ISE's efforts to distinguish public retail customer orders from public "professional" customers for the purposes of determining trading priority and exchange transaction fees. The Options Committee hopes to work directly with the ISE and the Commission to develop appropriate and reasonable procedures and guidelines which would successfully implement this proposal. The Options Committee is, however, concerned about the integrity and potential for inaccuracies in the suggested implementation methodology, as outline below.

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[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

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A. General Overview of Concerns

Under this proposal, the ISE proposes to require Electronic Access Members ("EAMs")[2] to identify a new category of customer orders, "professional customer orders,"[3] and apply a new options origin code to such orders. The ISE would impose the following conditions to professional customer orders: (1) charge the standard transaction fees currently applicable to broker-dealer orders; (2) limit fee waivers currently available to priority customer[4] orders; and (3) afford the same priority available to broker-dealers and market makers. The proposal requires that EAMs review their customers' activity on all exchanges on at least a quarterly basis to determine whether orders that are not for the account of a broker or dealer should be represented as priority customer orders or professional orders. EAMs would be required to impose a new origin code for professional customer orders starting within five business days following the review period.

The Options Committee is also concerned that under the proposed rule, EAMs will not be able to meet their obligations for monitoring and routing professional customer order flow, thus allowing professional customers to potentially "game" the system and inappropriately take advantage and avoid the purpose of the rule. The proposal will require significant costs in terms of system resources as more fully described below. The Options Committee would also like to point out that EAMs and Options Clearing Corporation ("OCC") members that clear such professional customer accounts will expend significant resources to comply with this rule, which may ultimately prove difficult, if not impossible, to achieve.

In addition, the vast majority of EAMs that route customer orders to the ISE are smart routing firms whose clients are other broker-dealers with customers that utilize a smart-routing system. The EAM has no ability to identify the end-user customer and count orders. Rather, under the proposal, it will be forced to rely on the good faith and effort of its broker-dealer client that introduces the order to identify the professional customer and code the order correctly. In many instances, these broker-dealer clients are not ISE members.

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[2] We note that not all members of the OCC are EAMs.

[3] ISE defines a "professional order" as an order for the account of a person or entity that is not a priority customer.

[4] ISE defines a "priority customer" as a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s).

Furthermore, because EAMs will need to rely on OCC clearing firms that ultimately clears the "professional customer" to identify such accounts, the following factors need to be considered:

1. **Order Breakdown.** In general, firms do not count the number of orders directed by customers under the same beneficial owners. Moreover, the majority of firms do not have the ability to break down for each customer account, by beneficial owner, the number of orders routed electronically (as opposed to physically) by a customer but not executed, versus the original customer order size and the number of fills.

2. **Limited Visibility.** Professional customers often spread their trading activity across multiple firms, including executing at one firm and then clearing at several other firms. Conversely, some customers execute through multiple EAMs and clear at one OCC clearing firm. Because professional customers use multiple firms, an ISE EAM and OCC clearing member's review of a customer account will be limited to the customer's activity at that respective firm, and cannot encompass the customer's entire portfolio.

3. **Clearing Firms vs. Executing Firms.** Professional customers can effect several orders in the same class and series (*i.e.*, the January 50 calls) that would be the equivalent of 390 orders, but clearing firms will only see the total number of cleared option contracts traded at the end of the day, and not the number of executions. For example, a customer clears 10,000 January 50 calls, but routes 10 lot orders over the course of the day. The clearing firm only sees that a customer cleared 10,000 contracts.

4. **Cancellations / Replaces / Modifications / Correction orders.** Clearing firms do not have access to information on a customer's cancellations, replaces, modifications, or corrections to orders. As a result, clearing-only firms do not have the ability to monitor this activity and, therefore, are not able to accurately determine whether a customer has placed more than 390 orders, the threshold number of orders for determining whether a customer is a "priority customer." As a result, the Options Committee does not believe clearing-only firms should be expected to try and calculate this order information.

5. **Clearing members do not always execute orders.** Clearing firms do not necessarily route orders to the ISE and, therefore, cannot mark orders appropriately as a professional or priority customer.

6. **Information Barriers Between Entities.** For those customers that do not have direct sponsored access, to properly implement the proposed monitoring

procedures, prime brokerage units and trading/executing units within a single firm would have to share certain customer information which would be contrary to existing information barriers and which may raise privacy concerns. Although someone above the information barrier would identify a customer as a professional customer account, in order to implement this change across direct market access ("DMA") trading platforms and traditional trading/executing entities, this information would have to be disseminated across multiple desks, which would usually not be privy to this information. As a result, customer trading information could be potentially disseminated across desks that are typically separated by existing electronic and physical information barriers. The Options Committee requests specific guidance on how to implement the proposed requirements without violating applicable privacy regulations.

B. Technical and Operational Issues

The Options Committee also notes that there are several important technical and operational issues which should be considered prior to adopting the proposed rule. SIFMA notes that some of these changes are so critical and expensive that firms may elect to route business away from the ISE, instead of implementing these changes. First, the implementation of options symbology is imminent and will require considerable resources within each firm. This may limit a firm's ability to allocate already scarce resources to this undertaking.

The proposal also adds a new order type which could impact a myriad of systems used by firms. For example, most electronically routed customer orders are routed to multiple exchanges, thus all order execution platforms would have to be updated such that they can differentiate customer types only for a single exchange. A firm's system would also have to be flexible enough to manage changes to a customer's designation on a quarterly basis. In addition, it should be noted that many firms use multiple systems, such as internal, vendor, algorithmic platforms, and exchange-driven systems, to route option order flow, and this requirement would need to be implemented for multiple platforms at a single firm.

Furthermore, the OCC currently does not differentiate different order types so operations groups using the OCC's Encore system would only see Customer "C" order type designation, making it impossible to differentiate between types of customers. Also, systems for review of orders based on execution count would have to be developed across the industry.

In addition, EAMs and brokers using smart routers may have to introduce systemic and procedural enhancements that will allow for effective tracking of the additional fees. This is not a trivial issue since existing relationships may be priced on economic terms that will significantly change with the introduction of a new fee.

It should be further noted, that professional customers could electronically route orders to an exchange without this order type designation and, due to linkage and best execution requirements, would be linked to the ISE without a professional customer designation. Members of the other exchanges would not be able to recognize that this was a professional customer order. Since OCC clearing members are not all EAMs, and the professional customers who are routing orders are sophisticated, it is unfortunately possible that such customers could circumvent the intention of the rule.

The Options Committee is also very concerned that large retail firms may have additional difficulties implementing a new origin code within the timeframe set forth in the proposal. The proposal provides for only a 5-day window after the end of a quarter to start coding for professional customers, which SIFMA believes is unrealistic.

In addition, the Options Committee believes that a large educational initiative will need to be undertaken across the industry for this proposal to successfully move forward.

Finally, the Options Committee believes that this proposal could require significant revisions to the customer option account agreements across the industry, because customers would have to be designated as professional customers, and potentially enter this information directly into an electronic order routing platform. In addition, the customer would need to acknowledge that additional fees could be assessed. Such an effort will take significant time and resources.

C. Suggested Solutions

The Options Committee recommends that the ISE consider several alternatives for implementing the proposal before it is finalized. For example, the Committee believes that the ISE should monitor customer compliance with the proposed rule by identifying "a pattern and practice" suggestive of the professional customer, and only require the new origin code be adopted after thorough investigation. The ISE should also reach out to each of its EAMs to proactively review these findings on a quarterly basis in a constructive manner and in conjunction with potential blue-sheet requests in order to confirm systematically that a "professional customer" designation is required, and that accounts are being properly identified under the ISE rules, and calculate fees accordingly. Furthermore, to prevent gaming of the rule, ISE should analyze these reports across broker-dealers because, as mentioned above, professional customers often have accounts at multiple firms.

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As a result of all of the issues cited in this letter, the Options Committee requests that the proposal be revised in accordance with this letter and re-filed with the Commission. The Committee further requests that any final rule become effective at least 12 months after approval to allow the industry time to implement the required operational changes, as well as implement training within firms.

We look forward to continuing a dialogue on these important issues. If you have any questions, please call me at 202-962-7385 or email me at mmacgregor@sifma.org.

Regards,

Melissa MacGregor

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