ISE
INTERNATIONAL SECURITIES EXCHANGE

60 Broad Street, New York, NY 10004
TEL: 212 943-2400
FAX: 212 425-4926
www.ise.com

January 12, 2009

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

Re: File No.ISE-2006-26 – Response to Comment Letter

Dear Ms. Harmon:

The International Securities Exchange, LLC ("ISE" or "Exchange") submits this letter in response to a comment letter received by the Commission regarding the above referenced rule filing (the "Proposal") from the Options Trading Committee ("Options Committee") of the Securities Industry and Financial Markets Association ("SIFMA").[1] Under the Proposal, orders not for the account of a broker-dealer will be categorized as either "Priority Customer Orders" or "Professional Orders" based upon the number of orders placed by the customer. Currently, all orders not for the account of a broker-dealer are categorized as "Public Customer Orders." The new definitions would only apply with respect to specified ISE rules related to execution priority and the Exchange's fee schedule.

The SIFMA letter discusses what the members of the Options Committee believe are regulatory burdens and compliance difficulties, and raises a number of other issues related to implementation of the rule. The Options Committee's comments are almost entirely based on the assumption that compliance with the rule will require analysis by the ISE member's clearing firm of cleared data provided by The Options Clearing Corporation ("OCC"). As discussed in detail below, this assumption is not correct. Thus, we do not believe that the letter raises any substantive issues, and we urge the Commission to approve the Proposal promptly.

- **The Proposal places a requirement on the broker-dealer that has a relationship with, and knows, the ultimate customer to properly identify its customer orders.**

Under the Proposal, the broker-dealer that receives orders from the ultimate customer – not the clearing firm – will be required to monitor the number

[1] Letter from Melissa MacGregor, Vice President & Assistant General Counsel, SIFMA, dated July 23, 2008.

of orders it receives from each customer and to mark the orders correctly. These types of activities are routinely performed by broker-dealers who deal directly with customers. The ISE has consulted with a variety of broker-dealers that accept orders directly from customers. These firms did not believe that it would be difficult for them to determine, on a quarterly look-back basis, whether a particular customer had on average entered more than 390 orders per day during any month. As stated in the filing, an average of more than 390 orders per day is far greater than the number of orders typically entered by even the most active retail investor. Broker-dealers have a regulatory responsibility to know their customers, and, in fact, do know if they have customers that conduct this high level of activity.

- **Members that currently receive orders from other broker-dealers comply with existing order marking requirements without having customer information, and will be able to follow the same approach to comply with the Proposal.**

The Proposal requires the broker-dealer that has a relationship with, and knows, the ultimate customer to monitor the number of orders it is entering on the customer's behalf and to conduct a quarterly review to assure it is marking the orders appropriately. If an ISE member accepts orders from another broker-dealer, the ISE member does not know the ultimate customer and would therefore be unable to count the number of orders entered by a particular customer. In such case, the ISE member would need to have reasonable procedures in place to confirm that its broker-dealer customer has implemented the appropriate procedures to comply with the requirement.

The ISE and all of the other options exchanges currently have a variety of order marking requirements for which ISE members that route orders on behalf of other broker-dealers have regulatory responsibility. For example, ISE members are currently required to mark orders as for the account of a public customer, a firm's proprietary account, the account of another broker-dealer, or the account of an options market maker on another exchange.[2] Members that receive orders from other broker-dealers rely on those broker-dealers to mark orders appropriately today. Complying with the requirement contained in the Proposal would be handled by ISE members in the same manner as the existing order-marking requirements.

[2] Similarly, the CBOE issued a regulatory circular detailing 7 different order origin codes required for orders entered on its exchange. CBOE Regulatory Circular RG08-105, dated Sept. 16, 2008.

- **The Proposal does not require any post-trade analysis to determine the number of orders entered by a particular customer.**

As the SIFMA letter points out, it would not be possible to comply with the Proposal by looking at executed trades or options positions that result from executed trades. The SIFMA letter is correct that clearing firms, which receive information on executed contracts, do not have information regarding the number of orders entered by a particular customer. The number of orders entered by a particular customer has to be counted at the point of entry by the broker-dealer that receives the orders directly from the customer. Thereafter, such orders may be broken-up into multiple orders and routed to multiple exchanges, they may be cancelled or modified, they may only be partially executed, and they may be entered on the ISE by the same firm that also clears the trade or a different broker-dealer. However, none of these variations on what might happen to an order after it is placed by a customer will impact the calculation required by the Proposal.[3]

- **The proposal does not require members to measure a customer's trading activity across multiple broker-dealers.**

A professional customer may use multiple firms to execute and/or clear its trades, and a particular firm's view of a customer's overall activity will be limited. In addition to commenting that this would make it impossible for a particular order entry or clearing firm to measure the total number of orders entered by a particular customer through multiple broker-dealers (which is true as discussed above), the SIFMA letter raises concerns that customers may attempt to avoid being categorized as professional customers by opening accounts with multiple broker-dealers.[4] We agree that a broker-dealer cannot be required to measure the trading activity of its customers through other broker-dealers, and the Proposal does not place such a requirement on firms. While it might be impractical for a customer to conduct professional trading activities through multiple broker-dealer platforms, the Exchange will conduct surveillance designed to identify any such manipulative behavior. If the Exchange identifies such activities it will alert the relevant ISE member(s) of such customer trading patterns.

[3] As the SIFMA letter indicates, OCC does not differentiate between order types, and all executed contracts resulting from customer orders are designated "C." While this is true, the OCC designation for positions resulting from orders executed by customers is not relevant to the Proposal.
[4] The SIFMA letter also asserts that customers may try to avoid the requirements of the Proposal by routing orders to another exchange. *See infra*, note 5.

- **Marking orders would not violate information barrier requirements.**

The proposal requires members to count the number of orders entered by a customer on average per day during a month. This calculation would be on a post-trade basis and, as the SIFMA letter indicates, performed by a person (more likely a system or process) that is above any information barrier. Putting procedures in place to comply with the Proposal would not disclose information about the particular orders entered by a customer either pre- or post- trade, nor would it disclose information about any positions held by a customer. The Exchange is not aware of any information barrier rule or privacy regulations that would prevent a firm from marking an order as required under the Proposal.

- **Assuming the cost of systems changes is voluntary.**

In order to properly represent orders entered on the Exchange according to the new definitions, ISE members will be required to indicate whether a Public Customer Order is a Priority Customer Order or Professional Order. A broker-dealer that directs orders to the ISE, either directly as a member of the exchange or indirectly through another ISE member, will be required to append the appropriate code to orders that fall into the new Professional Customer category. We understand that this may require system changes for some broker-dealers. While we do not believe that such system changes will be particularly costly relative to other rule changes routinely made by the ISE and the other exchanges, routing orders to the ISE is voluntary. If such changes prove to be too costly, broker-dealers can choose to route orders to other exchanges.[5]

The SIFMA letter also asserts that this change will require systems changes to track ISE fees associated with the execution of Professional Customer orders. In this respect, we note that fees vary widely among the exchanges in terms of customer category, order type, execution service and product. Moreover, fee changes are frequent among all of the options exchanges. Firms routinely make changes in their systems to accommodate exchange fee changes.

---

[5] Through operation of the options linkage rules, other exchanges are not permitted to trade through a better price on the ISE. Under the current linkage rules, other exchanges may send a principal acting as agent order (P/A Order) to the ISE to get the better price on behalf of the customer. Thus, orders for the account of what the ISE would consider a Professional Customer may be routed to other exchanges that do not have the same definition, and such orders may ultimately receive the price available on the ISE indirectly.

- **The Proposal provides sufficient time for implementation.**

SIFMA asserts that the rule does not give firms sufficient time to implement the new Professional Customer designation. The Proposal specifies that a firm must start marking Professional Customer orders appropriately within five days following its quarterly review of customer trading activity. While it may take longer than five days for a broker-dealer to make the system changes necessary to accommodate the new order code, once these initial systems changes are implemented, the Exchange believes five days is sufficient to change the order code associated with a particular customer account. Members will be given a reasonable amount of time following approval of the rule to make the initial systems changes, which will be not less than one full quarter.[6]

- **The need to amend customer account agreements, if any, should be very limited.**

It is possible that the proposal may require some broker-dealers to revise certain customer account agreements. Generally speaking, execution priority and execution fees vary greatly among the options exchanges today. To the extent that a customer account agreement currently specifies the different execution principles and fees that may be applicable on the different exchanges, such as the treatment of customer orders routed to options exchanges that do not provide customer order priority now or routed to options exchanges that are currently charging maker-taker fees, then it might also be necessary for those firms that have professional customers to amend their account agreements to specify the priority and fees that will apply when professional customer orders are routed to the ISE. However, this would be no different than changes that would be necessary for any other changes to customer priority rules or fees, such as for maker-taker fees.

* * *

The Exchange believes this letter clarifies why the substantive issues raised in the SIFMA letter are not applicable to the implementation of the Proposal. The Exchange therefore respectfully requests that the Commission promptly approve the Proposal. As stated in the filing, the Exchange believes retail investors currently are being prevented from fully benefiting from the priority advantage given to Public Customer Orders under the Exchange's rules. In

[6] The Exchange will work with its members to assure there is adequate time to implement systems changes as necessary. However, the Exchange does not agree with SIFMA's request that the rule not become effective for 12 months followings its approval. Such a protracted period of time is not necessary given the limited scope of the Proposal and its voluntary nature.

addition, approval of the Proposal will further fair competition among professionals by treating them equally within the ISE marketplace.

Sincerely,

Michael J. Simon
Secretary