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

RE: Securities Exchange Act Release No. 34-54603  
File No. SR-ISE-2006-62

Dear Ms. Morris:

The Chicago Board Options Exchange, Incorporated ("CBOE") is pleased to submit its comments on the above proposed rule change by the International Securities Exchange ("ISE"), which proposes to implement a Pilot Program to quote and trade certain options in pennies ("Penny Pilot Program").

CBOE's comments focus on one aspect of ISE's rule change, namely, ISE's usage of a "Holdback Timer" to limit ISE's dissemination of quotations as a quote mitigation strategy. At this point, CBOE does not necessarily have any fundamental objection to ISE's usage of a "Holdback Timer". However, CBOE believes ISE should be required to provide more information concerning how the "Holdback Timer" functions and how it may impact the execution of orders sent to ISE by CBOE members or by CBOE through linkage.

In its rule change, ISE describes the "Holdback Timer" as a tool to help prevent the flickering of quotations due to market-makers adjusting their quotes when there is a change in the price of a security underlying an option. ISE states that "[r]ather than disseminating each individual change, the holdback timer permits the exchange to wait until all market makers have adjusted their quotes and then to disseminate a new quotation." ISE recently amended its rule filing to expressly state that ISE will utilize the "Holdback Timer" to delay quotations and other changes to ISE's BBO. ISE provides no other information concerning the "Holdback Timer".

CBOE believes that ISE should explain and disclose more information concerning the "Holdback Timer". In particular, CBOE raises the following questions concerning ISE's "Holdback Timer":

- Is the "Holdback Timer" utilized in all option classes traded on ISE? Is the "Holdback Timer" uniform across all classes in which it is used, or does its duration vary by option class?
- Is the "Holdback Timer" used periodically throughout the trading day, or only during periods of significant quote traffic?

- Does ISE intend to disclose the length of the timer to its members? Does it intend to disclose the length of the timer to nonmembers and other exchanges that route orders to ISE?
- Does the “Holdback Timer” only apply to market maker quotations? If a customer limit order improves ISE’s disseminated quote, does the “Holdback Timer” prevent dissemination of the internal improved quotation by the customer limit order until the end of the timer period, and allow market-makers to “catch-up” to the customer limit order’s internal improved quotation during the timer period?
- What does the “Holdback Timer” actually delay the dissemination of? All price changes to ISE’s BBO? All size changes to ISE’s BBO? Size changes that decrease ISE’s disseminated size? Size changes that increase ISE’s disseminated size? Does it vary by option class in terms of what is delayed?
- Do in-coming marketable orders automatically trade against ISE’s disseminated quote (that possibly has been delayed for up to 1-second), or do they automatically and immediately trade against the current internal quotation that is being held during the 1-second holdback period?

For example, assuming ISE’s “Holdback Timer” is operational in a Penny Pilot option class and is set to 1-second. If ISE’s BBO that has been disseminated to OPRA is 1.00 to 1.05, and a market maker improves ISE’s best bid to 1.01 a tenth of second later, does an in-coming market order to sell execute at 1.00 or 1.01? Or, is the in-coming market order held until the conclusion of the 1-second holdback period, and then execute against the new disseminated quote? Does the answer change depending on whether a market maker improves the quote during the holdback period as opposed to a customer limit order?

In another example, again assume ISE’s “Holdback Timer” is operational in a Penny Pilot option class and is set to 1-second. Further assume that CBOE’s disseminated market is 1.00 to 1.05, and ISE’s BBO that has been disseminated to OPRA is 1.01 to 1.05, but during the holdback period the ISE market maker that submitted the 1.01 bid changes it to 1.00. If CBOE receives a market order to sell, CBOE is required to and would route a 1.01 P/A limit order to ISE through the linkage. At what price would the P/A order CBOE sent to ISE be executed? Would the P/A order be cancelled because ISE’s internal quote is no longer 1.01? Alternatively, if during the holdback period a market maker improved ISE’s best bid to 1.02, would the P/A order be executed at 1.02, or at the best bid ISE disseminated to OPRA of 1.01? Similar questions arise if the size of ISE’s best bid is reduced or increased during the holdback period.

It is crucial that all market participants understand how the timer functions and how it may effect the execution of orders sent to ISE through the “front door” as well as through linkage. Because exchanges are essentially compelled to route linkage orders to each other throughout the trading day, it is vital to understand how those orders are being handled as well as whether the quote that those orders are trying to access is accurate.

Respectfully Submitted,



Patrick Sexton