BOX
BOSTON OPTIONS EXCHANGE

May 2, 2008

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File No. SR- ISE-2008-28

Dear Ms. Morris,

The Boston Options Exchange ("BOX") appreciates the opportunity to comment on the International Securities Exchange's ("ISE") proposal to expose public customer orders that are not executable on ISE before sending an order through the intermarket linkage system ("Linkage Order") on behalf of a public customer ("Proposal").[1]

When ISE's best bid or offer ("BBO") is inferior to the national best bid or offer ("NBBO"), public customer orders are not automatically executed. A primary market maker ("PMM") is obligated to "address public customer orders that are not automatically executed because there is a displayed bid or offer on another exchange trading the same options contract that is better than the best bid or offer on the Exchange, either (i) by executing a public customer order at a price that matches the best price displayed or (ii) by sending to any other exchange(s) displaying the best price a Linkage Order(s) according to the [ISE] Rules contained in Chapter 19 or (iii) by executing a public customer order at a price one minimum quoting increment inferior to the NBBO and contemporaneously sending a Linkage Order(s) to each exchange(s) disseminating the NBBO according to the [ISE] Rules contained in Chapter 19" as soon as practicable.[2]

ISE has proposed amendments to its rules whereby public customer orders would be exposed at the NBBO price, for a period of time not to exceed one second, to all ISE market makers before the PMM sends a Linkage Order to another exchange.[3] Furthermore, at the conclusion of the exposure period, orders will be executed against responses that are equal to or better than the then-current NBBO if the order is

[1] *See* Securities Exchange Act Release No. 57551 (March 25, 2008), 73 FR 16917 (March 31, 2008) (SR-ISE-2008-28).

[2] *See* ISE Rule 803(c)(2).

[3] *See* Securities Exchange Act Release No. 57551 (March 25, 2008), 73 FR 16917 (March 31, 2008) (SR-ISE-2008-28).

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executable at the then-current NBBO and ISE is not at the then-current NBBO.[4] If the "order cannot be executed in full on [ISE] at the then-current NBBO or better, and it is marketable against the then-current NBBO, the PMM will send a Linkage Order."[5]

Rule 602 of Regulation NMS states that a "broker or dealer shall be obligated to execute any order to buy or sell a subject security, other than an odd-lot order, presented to it by another broker or dealer, or any other person belonging to a category of persons with whom such responsible broker or dealer customarily deals, at a price at least as favorable to such buyer or seller as the responsible broker's or dealer's published bid or published offer (exclusive of any commission, commission equivalent or differential customarily charged by such responsible broker or dealer in connection with execution of any such order) in any amount up to its published quotation size" ("Quote Rule").[6]

At the time the PMM is presented with the order, the PMM may choose whether to execute the order himself or under the Proposal to expose the order prior to sending a Linkage Order. Based on Scenario 3 in the Division of Trading and Markets' Staff Legal Bulletin No. 16, "the Quote Rule requires a responsible broker-dealer to execute an order at its quote when that order is presented."[7]

The Proposal states that "if at the end of the exposure period, the order is executable at the then-current NBBO and the ISE is not at the then-current NBBO, the order will be executed against responses that equal or better the then-current NBBO."[8] Since the Proposal, however, does not address the situation when ISE does meet the then-current NBBO at the conclusion of the exposure period, we do not believe that the Proposal allows for the following examples to be clearly addressed. Pursuant to the Quote Rule, we believe that the Proposal would work as follows:

Example 1

Public Customer A enters an order to Sell 20 contracts XYZ at market. At the time of the order entry, the NBBO is \$2.10 - \$2.15 and the ISE BBO is \$2.05 – \$2.15 for 20 contracts, with the PMM at \$2.05 - \$2.15 for 20 contracts. Under the Proposal, since the ISE BBO is inferior to the

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[4] *Id.*

[5] *Id.*

[6] 17 CFR § 240.602(b)(2).

[7] *See* Staff Legal Bulletin No. 16: Transactions in Listed Options Under Exchange Act Rule 11Ac1-1, Scenario 3 (January 20, 2004).

[8] *See* Securities Exchange Act Release No. 57551 (March 25, 2008), 73 FR 16917(March 31, 2008) (SR-ISE-2008-28).

displayed NBBO at the time of entry, the order would be exposed to ISE market makers for a period not to exceed one second.

During the exposure period, the PMM lowers his quoted size and is now $2.05 - $2.15 for 10 contracts, resulting in ISE BBO being the same.

At the conclusion of the exposure period the NBBO has faded to $2.05 - $2.15.

Assuming no responses, according to the Proposal, we believe Public Customer A's order would be executed at the then-current NBBO at $2.05 for 10 contracts. The remaining 10 contracts of Public Customer A's order would be routed immediately as a Linkage Order to the market(s) now bidding at $2.05.

According to the Quote Rule, however, the PMM must execute Public Customer A's order at $2.05 or better for 20 contracts as it was the PMM's quote at the time the order was presented to the PMM. Therefore, under the Proposal, Public Customer A's order has been executed on ISE at an inferior size (10 contracts) in violation of the Quote Rule.

<u>Example 2</u>

Public Customer A enters an order to Sell 20 contracts XYZ at market. At the time of the order entry, the NBBO is $2.10 - $2.15 and the ISE BBO is $2.05 – $2.15 for 20 contracts, with the PMM at $2.05 - $2.15 for 20 contracts. Under the Proposal, since the ISE BBO is inferior to the displayed NBBO at the time of entry, the order would be exposed to ISE market makers for a period not to exceed one second.

During the exposure period, the PMM changes his quoted price and size to $2.00 - $2.15 for 10 contracts, resulting in ISE BBO being the same.

At the conclusion of the exposure period the NBBO has faded to $2.00 - $2.15.

Assuming no responses, according to the Proposal, we believe Public Customer A's order would be executed at the then-current NBBO at $2.00 for 10 contracts. The remaining 10 contracts of Public Customer A's order would be routed immediately as a Linkage Order to the market(s) now bidding at $2.00.

According to the Quote Rule, however, the PMM must execute Public Customer A's order at $2.05 or better for 20 contracts as it was the PMM's quote at the time the order was presented to the PMM. Therefore, under the Proposal Public Customer A's order has been executed on ISE at an inferior price ($2.00) and size (10 contracts) in violation of the Quote Rule.

Example 3

Public Customer A enters an order to Sell 40 contracts XYZ at market. At the time of the order entry, the NBBO is $2.10 - $2.15 and the ISE BBO is $2.05 – $2.15 for 40 contracts, with Competing Market Maker ("CMM") #1 and CMM #2 at $2.05 - $2.15, both for 20 contracts. The PMM is quoting at $2.00 - $2.15, for 20 contracts. Under the Proposal, since the ISE BBO is inferior to the displayed NBBO at the time of entry, the order would be exposed to ISE market makers for a period not to exceed one second.

During the exposure period, CMM #1 cancels his quote, and CMM #2 lowers his size to 10 contracts. As a result, the ISE BBO is $2.05 - $2.15 for 10 contracts, with the PMM at $2.00 - $2.15 for 20 contracts.

At the conclusion of the exposure period the NBBO has faded and is now $2.00 – $2.15.

Assuming no responses, according to the Proposal, we believe Public Customer A's order would be executed with CMM #2 at $2.05 for 10 contracts and then with the PMM at the then-current NBBO of $2.00 for 20 contracts. The remaining 10 contracts of Public Customer A's order would be routed immediately as a Linkage Order to the market(s) now bidding at $2.00.

Under the Quote Rule, however, Public Customer A's order must execute at $2.05 or better for 40 contracts as the BBO on ISE was $2.05 for 40 contracts at the time the order was presented. Therefore, under the Proposal, Public Customer A's order has been executed on ISE at an inferior price ($2.00) and size (30 contracts) in violation of the Quote Rule. We do not understand why the Proposal does not protect the public customer order by invoking the firm quote protection afforded by the CMM's quote.

Example 4

Public Customer A enters an order to Sell 20 contracts XYZ at market. At the time of the order entry, the NBBO is $2.10 - $2.15 and the ISE BBO is $2.09 – $2.15 for 20 contracts, with the PMM at $2.09 - $2.15 for 20 contracts. Under the Proposal, since the ISE BBO is inferior to the displayed NBBO at the time of entry, the order would be exposed to ISE market makers for a period not to exceed one second.

During the exposure period, the PMM changes his quote to $2.08 - $2.15 for 10 contracts, resulting in the ISE BBO being the same. Then the NBBO fades to $2.08 - $2.15 to match the ISE BBO.

According to the Proposal, at this moment "the exposure period will be terminated if the exposed order becomes executable on the ISE at the prevailing NBBO."[9] Therefore, we believe Public Customer A's order would be immediately executed at $2.08 for 10 contracts. The remaining 10 contracts of Public Customer A's order would be routed immediately as a Linkage Order to the market(s) now bidding at $2.08.

According to the Quote Rule, however, the PMM must execute Public Customer A's order at $2.09 or better for 20 contracts as it was the PMM's quote at the time the order was presented to the PMM. Therefore, under the Proposal, Public Customer A's order has been executed on ISE at an inferior price ($2.08) and size (10 contracts) in violation of the Quote Rule.

Example 5

In addition to the previous examples, we believe it is not clear how a public customer order would be handled in the following case:

Public Customer A enters an order to Sell 40 contracts XYZ at market. At the time of the order entry, the NBBO is $2.10 - $2.15 and the ISE BBO of $2.10 – $2.15 for 20 contracts matches the NBBO price instead of being inferior. We assume that 20 contracts are automatically executed at $2.10. Under the Proposal, we are uncertain what would happen next. Are the remaining 20 contracts immediately routed as Linkage Orders? Or, assuming ISE BBO no longer matches NBBO, are the remaining 20 contracts now handled according to the Proposal and exposed on ISE for one second?

[9] *Id.*

We do not believe it is in the public interest that under this Proposal the PMM can execute public customer orders at the then-current NBBO when the then-current NBBO is inferior to the price or size on ISE at order presentment as is required under the Quote Rule, and pursuant to Scenario 3 in the Division of Trading and Markets' Staff Legal Bulletin No. 16. As shown in the aforementioned examples, we believe this Proposal would be a violation of the Quote Rule. If this is not a correct interpretation of the Proposal, please explain how this Proposal complies with the Quote Rule. Please do not hesitate to contact me at (617) 235-2235 if you have any questions or comments.

Sincerely yours,

L. J. Fall

Lisa J. Fall
General Counsel

cc: Elizabeth King
Heather Seidel