January 7, 2009

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

Re: SR-ISE-2008-92

Dear Ms. Morris:

thinkorswim, Inc. ("thinkorswim") appreciates the opportunity to comment on the International Securities Exchange, Inc.'s (the "ISE's" or the "Exchange's") above-referenced proposal (the "Proposal") to modify the application of its cancellation fee.[1] thinkorswim, founded in 1999 and headquartered in Chicago, is a leading online brokerage company specializing in options. thinkorswim supports retail and institutional traders through our own trading platforms which are widely recognized as one of the industry's best for execution, professional analytics and real-time position management. thinkorswim is a member of the Financial Industry Regulatory Authority, Inc. ("FINRA").

The Exchange's current cancellation fee of $2.00 applies to Electronic Access Members ("EAMs") that cancel at least 500 orders in a month, for each order cancellation in excess of the total number of orders such member executed that month. This fee is currently charged only to customer orders. In determining an EAM's order executions for a month (solely for purposes of the cancellation fee formula), the ISE counts any order executed within a 30 second period as part of the same execution (the "Aggregation Window"). The Proposal drastically expands the current 30 second period to 300 seconds (*i.e.,* five minutes) which will attempt to capture even more orders for purposes of the cancellation fee.[2]

[1] SR-ISE-2008-92 as modified by Amendment No. 1 (December 9, 2008) ("Proposal); Securities Exchange Act Release No. 59072 (December 10, 2008) (Commission notice of the ISE's Proposal).

[2] It is important to note that the ISE's formula of aggregating order executions within the Aggregation Window serves to depress an EAM's executions for the month which in turn raises the number orders subject to the cancellation fee. The longer the timeframe for the Aggregation Window, the fewer eligible executions there are to offset the cancelled orders under the formula. The consequence of this is that more customer cancel requests will be subject to the fee.

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thinkorswim raised concerns about the ISE's cancellation fees and, specifically, the Aggregation Window when it was first introduced in 2006.[3] As noted in our previous letter, we believe the ISE's changes to its cancellation fees are not driven by capacity concerns or even recouping capacity costs, but instead are intended as a way to discourage self-directed customers from re-pricing orders.[4] As discussed in greater detail below, unlike other fees, the cancellation fee artificially changes the behavior of customers by inhibiting their ability to cancel and re-price orders. Market makers stand to benefit from these policies in that market makers trade such orders when they are moving against the customer. Given the persistent efforts of the ISE and other options exchanges to further expand the fee to the detriment of customers while benefiting market makers, we believe the Securities and Exchange Commission ("Commission") cannot treat these proposals as simple "fee filings." These fees are detrimental to customers in terms of both higher effective spreads and actual costs charged by the ISE and passed through to the customer. The Commission must apply greater scrutiny to fees that target customers and their ability to access better execution prices.

The fees and the Proposal raise significant customer protection concerns and thinkorswim urges the Commission to abrogate the ISE rule, pursuant to Section 6(e)(2) of the Securities Exchange Act of 1934 ("Exchange Act"). thinkorswim believes that the Commission must require any future cancellation fees be filed under Section 19(b)(2) so that sufficient public comment can be solicited.[5]

I. **The Proposal is not Equitable or Reasonable and Fails to Comply with the Exchange Act**

ISE's fees must provide for the "equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities."[6] The ISE has failed to provide sufficient information in its filing for the Commission and investors to evaluate the reasonableness of the Proposal. For example, the ISE states that the level of cancellations

[3] See Letter from Paul Mishkin, thinkorswim, posted on the SEC's website on May 25, 2006 (commenting on SR-ISE-2006-23 which introduced ISE's first aggregation formula for executions) ("2006 Comment Letter"); see Securities Exchange Act Release 53862 (May 24, 2006); 71 FR 31244 (June 1, 2006).

[4] See 2006 Comment Letter at 2.

[5] thinkorswim is not a member of the ISE, but fully expects that any increase in fees charged as a result of the implementation of the Proposal will be passed on to our firm.

[6] Section 6(b)(4) of the Exchange Act

targeted by the Proposal are "excessive"[7] suggesting that, in the ISE's view, these cancellations exceed some "normal" level of cancellations or are in some way not necessary cancellations.

The only way for a customer to control the execution price of an order is through limit orders. One of the natural consequences of penny pricing has been the increased reliance on limit orders because of the greater fluctuation across (penny) price points. Cancelling orders is the only way the public can update the prices of their orders and, in volatile markets, the consequence of not re-pricing an order is an inferior execution price. The recent spikes in volatility have increased the need to cancel and re-price orders. ISE's Proposal ignores the very real effects that recent market conditions have on customers. Volatility in the options markets have resulted in countless "missed markets" and have forced all market participants to cancel and re-enter more competitively priced orders to secure an execution. The markets have displayed record levels of volatility in recent months and it is not reasonable to penalize active customers by piling on cancellation fees.[8]

The ISE gives no indication in its filing that it has considered these factors in judging what level of cancellations it considers normal and what levels are excessive. Nor does the Exchange quantify the costs of capacity related to these cancellations. We presume that the cancellation fee will be reduced if and when the ISE's capacity costs are reduced. Without these numbers, the Commission and investors cannot know whether the fees collected are reasonable to achieve the ISE's stated goal.[9]

In addition, the ISE offers no rationale for why expanding the Aggregation Window will address the Exchange's stated concerns. The ISE states that "extending the aggregation window to five minutes will result in a reduction in the number of orders that are sent to the Exchange to create offsetting trades."[10] The Exchange describes, however, how easy it is for customers to sidestep

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[7] Proposal at 3. The Exchange states that "[r]ecognizing that order cancels and trades often happen in large numbers, the purpose of this fee is to focus on activity that is truly excessive and uses bandwidth and system capacity while fairly allocating costs among Members."

[8] We are aware that the ISE introduced a classification for "Voluntary Professionals" whereby non-broker-dealer customers may elect to be on equal terms with broker-dealer and market maker quotes to avoid the cancellation fee. Securities Exchange Act Release No. 57553 (March 25, 2008); 73 FR 16916 (March 31, 2008) (Order approving the Voluntary Professional classification). Choosing the Voluntary Professional classification, however, means that a customer's orders will lose its priority in the order execution process. Accordingly, we believe there will be many customers who will not want the Voluntary Professional designation. Creating the Voluntary Professional category does not absolve ISE from its responsibility to charge reasonable fees and apply them equitably across all users.

[9] It would follow that should ISE's capacity costs diminish in the future and the fees should be reduced as well. The Exchange's filing makes no provision for these adjustments.

[10] Proposal at 4.

the Exchange's formula by entering orders at different price levels.[11] Expanding the Aggregation Window to 300 seconds will not address this concern. If anything, it appears that expanding the timeframe will increase the incentives for customers to enter orders at multiple price levels. This means that the ISE's proposal to expand the Aggregation Window could have little effect addressing the stated concerns of ISE, *i.e.*, the level of customer cancellation requests and the offsetting order executions. ISE states that the additional executions of "smaller orders in deep out of the money options," including orders at multiple price levels, has "further increased capacity and bandwidth demands."[12] Given that the Proposal does nothing to alleviate the increased capacity demands that these orders create, we fail to understand why the Exchange believes the Proposal will serve its stated purposes. Furthermore, the Exchange does not provide any explanation for their selection of 300 seconds over 30 seconds, or any other timeframe. What analysis has the ISE performed to support a 900% increase in this timeframe? ISE must provide details as to how it determined 300 seconds would be an effective timeframe to achieve its desired result.

Under Section 6(b)(5) of the Exchange Act, the ISE's rules must not permit "unfair discrimination between customers...brokers, or dealers..." We believe the ISE's cancellation fee (including the current Proposal) violates this provision of the Exchange Act. The Exchange has not explained why cancellations from customers pose a threat to capacity and the cancellation of orders from non-customers does not. The Exchange does not explain why these bandwidth and capacity costs should be charged to customers and not to all users equally. Further, the current Proposal and its extension of the Aggregation Window is not simply a fee change but represents a limitation for customers to access the Exchange.

II. The Proposal Raises Significant Customer Protection Issues and Seeks to Favor Market Makers over Investors

The ISE's extended application of the cancellation fee poses significant harm to customer orders. Cancellation fees make it more costly and difficult for customers to respond to changes in market prices while they have an order pending at the Exchange. These fees tend to artificially change the behavior of customers and have the effect of freezing customer orders at a particular price and size. One consequence of the fees is a decrease in the placing of customer limit orders, which will result in a reduction in liquidity. Any expansion of the cancellation fee and the potential benefits to the ISE, therefore, must be weighed against the harm to customers. Since the ISE introduced the cancellation fee, the Exchange has focused solely on recouping capacity costs without analyzing the important market quality and investor protection issues at stake.

[11] Id. at 3. The ISE's Aggregation Window only applies to orders executed in the same series on the same side of the market at the same price (within the 300 second window).

[12] Id. at 4.

By discouraging customers to cancel and re-price their orders when markets move, the ISE's Proposal will disadvantage customers while favoring the market makers that interact with these orders. As noted above, cancelling orders is the only way the public can update the prices of their orders. For orders subject to the cancellation fee, the market maker has essentially a "free option" – the market maker can trade with an order that is moving against the customer.

What makes the cancellation fee (and any expansion of the fee) so troubling is that the Exchange has an economic incentive to discourage customers – especially informed, self-directed customers – from cancelling orders. This is so because the economics of the Exchange's market model is premised on maximizing the number of customer orders that interact with a market maker. Customer orders are not charged a transaction fee and have priority over professional orders. If customer orders are permitted to re-price freely, these orders have a greater opportunity to represent the best prices on the ISE and therefore have a greater likelihood of executing against other customer orders in the ISE book.[13] The Exchange loses a transaction fee when customers meet customers and the market makers are unable to capture the spread.

In addition, the Exchange and its market makers attract order flow by paying for customer orders.[14] When self-directed customers are able to match their orders against customer orders that were "paid for," the market maker has effectively been shut out of making a profit from the order.

For these reasons, we believe the primary driver of the cancellation fee is not to recoup capacity costs, but to reduce the number of times directed customer orders interact with "paid for" customers on the ISE book. The Commission must take a very serious look at the financial incentives at work given the Exchange's business model rather than the rationale supplied in the filing.

Given that market makers on the ISE stand to gain substantially if the "tax" on cancel requests is expanded, the Commission must give the Proposal special scrutiny. The ISE's expansion of cancellation fee is reminiscent of the steps the National Association of Securities Dealers, Inc.

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[13] Another problem with the ISE's cancellation fee is that the fee applies even when the re-priced order has joined the best price represented on the Exchange. These orders create additional liquidity at the best price and the Exchange should not be permitted to discourage them.

[14] Under the ISE payment for order flow arrangements, the Exchange pays some of its EAMs for order flow sent to the Exchange. The ISE assess fees to their Primary Market Makers ("PMMs") and Competitive Market Makers and at the direction of their PMMs, the ISE pays out cash to some EAMs. Under a typical payment for order flow arrangement with a market maker, the market maker offers an order entry provider cash or other economic incentives to route its customer orders to that market maker's designated exchange because the market maker expects that it will be able to trade with a portion of all incoming orders, including those from firms with which it has made arrangements to pay for order flow.

("NASD") took to limit the access of certain customers using the Small Order Execution System ("SOES").[15] ~~We raise this analogy because the NASD's actions had the effect of favoring the~~ interests of market makers over the interests of investors.[16] In 1988, NASD observed that the SOES order size limitations were being circumvented by the entry of a group or series of orders which individually may appear to be SOES eligible but were the result of one investment decision. To address this specific concern, NASD issued an interpretation of its SOES rules that "orders that are based on a single investment decision and that are entered by a SOES order entry firm for accounts under the control of an associated person or public customer will be deemed to constitute a single order and will be aggregated for determining compliance with the SOES order size limits. *Trades entered within any five-minute period in accounts controlled by an associated person or customer will be presumed to be based on a single investment decision.*"[17] We think most observers would agree that one of the consequences of this aspect of the SOES rules was a dysfunctional, and arguably anti-competitive, marketplace where market professionals gained an advantage over public customers.

Putting the ISE's Proposal into an historical context highlights how important it is for the Commission to carefully consider the Exchange's attempts to impose artificial restraints on the ability for customers to fully access the ISE systems. ISE first introduced its customer cancellation fee in July 2002. Since then, ISE has raised the fee or otherwise applied the fee more broadly to capture more customer cancellations *seven times*, all with the effect of further restricting customers from canceling orders. At $2.00, ISE charges the highest cancellation fee across the options industry and this Proposal has the potential to dramatically increase the number of customer requests subject to the fee. According to the ISE's own filings, no matter what the Exchange has proposed in the past, this fee has not been a successful method to curb cancellations. Over time, the ISE fee has distorted customer behavior to the detriment of customers and the benefit of market makers. The Commission should not allow this to continue without sufficient justification from the Exchange.

The Exchange should be required to re-file its rule with a careful analysis of the costs actually incurred by the Exchange in processing cancellation requests and a justification of the amount of the proposed fee. The Exchange should also set forth how it will use the funds collected

[15] By way of background, SOES enabled public customers to have their orders of limited size entered into the Nasdaq Market for immediate execution at the best available price. See NASD Notice to Members 88-61 (1988) ("NTM 88-61"). SOES was designed exclusively for individual agency orders of public customers and limited such orders to a maximum size.

[16] See Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the NASDAQ Market (August 8, 1996).

[17] NTM 88-61 at 2 (emphasis added).

pursuant to the cancellation fee program. Without more data to backup the ISE's claims, it appears the ISE is seeking to penalize customer orders without justification.

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If the Staff has questions regarding these comments, please contact the undersigned at (773) 244-6841.

Sincerely,

Peter D. Santori
Senior Vice President and General Counsel
thinkorswim Group Inc.