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August 27, 2012

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

Re: File No. SR-ISE-2012-22

Dear Ms. Murphy:

We submit this letter in response to the U.S. Securities and Exchange Commission's ("Commission") order instituting proceedings to determine whether to approve or disapprove the captioned proposed rule change of the International Securities Exchange, LLC ("ISE" or "Exchange").[1] We propose the listing and trading on ISE of cash-settled options based on the ISE Max SPY™ Index ("Max SPY Index," with such options being "Max SPY Options").

This letter supplements our initial letter on these proceedings[2] and responds to the latest letter by the Chicago Board Options Exchange, Incorporated ("CBOE") on this matter.[3] As a general matter, the CBOE Letter does not raise any new issues or concerns. Indeed this is the CBOE's fourth comment letter on our proposal and it generally reiterates irrelevant or incorrect arguments from the prior three comment letters. While we respond to a number of the these comments below, CBOE's inability to raise any legitimate issues under the Securities Exchange Act of 1934 ("Exchange Act") confirms that the comment process has run its course and that the next step in these proceedings is for the Commission to approve our proposal.

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[1] Securities Exchange Act Release No. 67225 (June 20, 2012), 77 FR 38100 (June 26, 2012) (the "Order").

[2] Letter dated August 10, 2012 from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission ("Initial Letter").

[3] Letter dated August 10, 2012, from Edward T. Tilly, President and Chief Operating Officer, CBOE, to Elizabeth M. Murphy, Secretary, Commission ("CBOE Letter"). The Commission received other letters on our proposal, both in support and in opposition. Letters opposing the proposal either raised issues not relevant to the Commission's consideration of the filing (such as intellectual property concerns) or simply restated issues the CBOE has raised. By responding to the CBOE Letter we will be responding to all relevant issues.

Litigation Risk Does Not Pose a Potential Harm to Investors

CBOE continues to argue that investors face unprecedented risk and uncertainty in trading Max SPY Options. In our previous comment letters we discussed how this was not a unique risk and how there were multiple layers of protection available for investors. We need not repeat those facts in this letter. However, CBOE makes one argument that is so egregious that we must clarify the record: that investors who take positions in Max SPY Options would not be "innocent" third parties deserving of court protection because they would be engaging in actions "unlawful under an *existing* injunction."[4] On this faulty factual base, the CBOE then reasons that it is unlikely that a court would permit closing transactions if it overturned a lower court ruling that the current injunction does not apply to Max SPY Options.

This argument shows how the CBOE twists facts in an attempt to support a meritless claim. As we have repeatedly stated, we will not commence trading Max SPY options until we receive a court ruling that the current injunction does not apply to our trading of this product. Thus, any trading in Max SPY options would occur only if there is a ruling specifically stating that such trading is lawful. Directly contrary to the CBOE's twisted view of the issue, we believe that an appeals court would be extremely sympathetic to investors who took positions in Max SPY options during such lawful trading, and would permit investors to engage in an orderly unwinding of those positions. Nevertheless, as detailed in our Initial Letter, there are additional protections available for investors in this instance, and our disclosure will detail such protections.

The Max SPY Options are Based on the Max SPY Index

CBOE continues to argue that the calculation of the ISE Max SPY and its settlement value is subjective and inappropriate. That is not the case. The equation we have provided is correct, and just like any equation for index calculation, is made in generic form. The mutual fund industry, including the exchange-traded fund ("ETF") industry, calculates the net asset value ("NAV") of funds in the same manner: take the total assets of the fund, less liabilities, and divide by the number of shares outstanding. As the ETF industry approaches its 20th anniversary, there has been no confusion or controversy in this area. ISE uses a well-known market data vendor in the industry, Interactive Data Corp., to perform the same calculation. Considering that no ETF prospectus even provides a formula for this standardized process, we feel that our generic formula could further help investors understand the basic elements of an NAV calculation. CBOE, on the other hand, provides no detailed information, explanation, or formulae on the special opening quotation ("SOQ").[5] Both the SOQ and NAV calculations are standardized processes.

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[4] CBOE Letter at 4 (emphasis in original).

[5] As discussed in our Initial Letter, investors of SPX options must rely on another exchange, the Chicago Mercantile Exchange, to better understand the SOQ process.

The source of our data is the National Securities Clearing Corporation ("NSCC"), which receives its data from the custodial bank of the fund. The liabilities of the fund (accrued dividends, fund manager fees, etc.) are netted as a cash component by the custodial bank, and NSCC provides that information within its daily data files.[6] ISE does not alter this number. Rather, it combines it with the closing prices of the underlying SPY Trust's portfolio components, and then multiplies by ten. We do not perform the fund's accounting, and we do not try to estimate any accrued dividends. We simply use the daily NSCC file, by way of our vendor, that the rest of the industry has been using for years with no record of confusion (other than, apparently, CBOE).

CBOE includes in its comment letter a four-page declaration of Professor Robert Whaley, along with a 12-page *vita* of the professor. We fully recognize Professor Whaley's illustrious career and long-standing collaboration with the CBOE to develop its proprietary products. However, none of his works have focused on the difference between the market price of an ETF and its NAV, which appears to be the center of CBOE's purported concerns.

We believe that rather than supporting CBOE's position, Professor Whaley's declaration actually supports us by underscoring an issue we raised in our Initial Letter regarding the settlement of SPX Index Options via its SOQ. Specifically, the SOQ can deviate from the opening price of SPX, just as the closing price of the Max SPY Index can deviate from its settlement value, and just as SPY can deviate from its NAV. None of this is new. Indeed, the SPY prospectus has highlighted this for the almost two decades that it has been published.[7] Professor Whaley's declaration should end this debate: the settlement prices of both Max SPY Options and SPX options can vary from their underlying values, and whether one is "more different" or "less different" isn't material. In all such cases adequate disclosure provides the investing public with the information they need to make informed decisions. Nevertheless, we do note that, of all the data points available, Professor Whaley has chosen the height of the global financial crisis to illustrate his point of how the ISE Max SPY index can deviate from its settlement value.

<u>Max SPY is Properly Categorized as a Security Index</u>

CBOE continues to devote a great deal of effort to argue that an index must have more than one component. There is no legal basis for CBOE's position. Not a single provision of the Exchange Act or the rules implementing that act require an index to have more than one component. If there was, CBOE

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[6] With respect to CBOE's specific comments on our formula, $NAV_{SPY(t)}$ obviously refers to the ISE calculation of the SPY Trust NAV using NSCC data. The references to cash and fees in the formula are illustrative, as the NSCC daily file provides the netted cash position of the Trust. We cannot list every liability because that information is not available. On the last trading day, the prices of the portfolio components are the closing prices on the primary markets that day. All other inputs come from the NSCC file from the prior night, as stated in our Initial Letter.

[7] SPY prospectus, page 79.

simply would have referenced that authority somewhere in its four comment letters, rather than expending so much effort trying to support its position by pointing to irrelevant statutory provisions (such as the definition of "security future") and promotional websites on existing products.

Indeed, the CBOE has stooped to the last resort of a party without a legal basis for its argument, literally using the tired cliché of saying the ISE is attempting "to poke the proverbial camel's nose under the tent." Effectively, the CBOE is arguing that the Commission should disapprove this proposal not because of specific concerns with this proposal, but because of concerns of what *future* proposals may rely on this precedent. We do not seek to justify any proposals other than Max SPY Options, nor is there any statutory requirement that we do so. The Commission is fully capable of analyzing any future proposal under the requirements of the Federal securities laws. Because our *current* proposal is fully compliant with those laws, the Commission should approve our trading of options on the Max SPY Index.

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For the reasons set forth above, we respectfully request that the Commission approve the proposed rule filing. If you have any additional questions, or if we can be of further assistance in this matter, please do not hesitate to contact us.

Sincerely,

Michael J. Simon
Secretary