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May 4, 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 comments submitted to the U.S. Securities and Exchange Commission ("SEC" or "Commission") by the Chicago Board Options Exchange, Incorporated ("CBOE")[1] and The McGraw-Hill Companies, Inc. ("McGraw-Hill")[2] on the above-referenced rule filing in which the International Securities Exchange, LLC ("ISE") proposes to amend its rules to provide for the listing and trading of options on the ISE Max SPY™ Index on the ISE.[3]

Introduction

CBOE's Letter claims that ISE's proposal to trade options on the ISE Max SPY™ Index, as described in ISE's rule filing: would violate an existing Illinois state court injunction; contains misleading characterizations of the proposed options; and raises other significant issues that warrant either disapproval of the proposal or substantial alteration of the filing to address those issues. McGraw-Hill's Letter alleges that the proposed options would involve use of the S&P 500® Composite Stock Price Index ("S&P 500"). It claims that this violates Standard & Poor's Financial Services LLC's ("S&P") intellectual property rights. It also claims that offering the options would violate a permanent injunction, entered by the Illinois Circuit Court.

Each of these claims by CBOE and McGraw-Hill are factually inaccurate and are nothing more than a smokescreen attack on ISE's efforts to bring a new, lawful, proprietary, competitive, index option product to market. Because the

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[1] Letter from Edward T. Tilly, President and Chief Operating Officer, CBOE, dated April 13, 2012 ("CBOE Letter").
[2] Letter from Kenneth M. Vittor, Executive Vice President and General Counsel, The McGraw-Hill Companies, Inc., dated April 11, 2012 ("McGraw-Hill Letter").
[3] Securities Exchange Act Release No. 66614 (March 16, 2012), 77 FR 16883 (March 22, 2012) (Notice for ISE-2012-22).

proposed options on the ISE Max SPY™ Index constitute a real and meaningful threat to CBOE's monopoly franchise, CBOE is employing every possible tactic to thwart ISE's efforts to legally compete, including taking positions that are contrary to well-known, well-settled legal and regulatory principles. For the reasons discussed herein, ISE urges the Commission to approve the proposal.

<u>CBOE Attempts to Prevent the SEC from Approving this Rule Filing by Circuitously Bootstrapping Intellectual Property Issues into this Rule Filing</u>

Since 2006, ISE, CBOE, and McGraw-Hill have been parties in an Illinois state litigation contesting whether ISE could offer SPX and Dow Jones Industrial Averages ("DJIA") options to the public without permission of McGraw-Hill and Dow Jones. The Illinois trial court ruled against ISE in July 2010 and entered a permanent injunction barring ISE from offering or listing SPX options and DJIA options. The injunction did not bar ISE from offering any other option product. ISE has appealed from the injunction judgment and the appeal is awaiting a decision by the Illinois Appellate Court.

On March 23, 2012, CBOE and McGraw-Hill filed a "Motion to Enforce Permanent Injunction" against ISE in Illinois state court (the "Motion").[4] Although ISE Max SPY™ options were not addressed in the Illinois injunction, CBOE and McGraw-Hill are now seeking to have the Illinois court enjoin ISE from listing that product. ISE is opposing that Motion.

CBOE, leveraging its own attempt to expand the scope of the Illinois injunction, now asks the Commission to "...not take any action to approve ISE's proposed rule change until the litigation is resolved...[o]therwise the Illinois state court might incorrectly interpret the SEC order as a federal grant of approval to trade the Proposed Options that trumps the Illinois state court's consideration of the state law issues..."[5] McGraw-Hill urges a similar outcome.

CBOE and McGraw-Hill's speculation has no foundation. There has been no ruling or other suggestion from the Illinois court that its ruling on Illinois law issues would be influenced by the timing of the Commission's approval order. Nor is there any legal basis for their assertion that the Commission must delay approval of ISE's rule filing until the Illinois court decides the Motion. In fact, there is substantial SEC precedent holding exactly the opposite: that an SEC decision to approve a rule filing should be based solely on whether the proposal complies with the requirements of the Securities Exchange Act of 1934 (the "Act"), and without regard to any state law issues.

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[4] Attachment to CBOE Letter, Motion to Enforce Permanent Injunction, Case No. 06 CH 24798.
[5] CBOE Letter at page 2.

In 2007, CBOE was a defendant in a Delaware state lawsuit involving an interpretation of its membership rule regarding certain CBOE exercise rights. Concurrently, CBOE sought Commission approval of a rule filing involving that same membership rule that was the subject of the Delaware state lawsuit. The plaintiffs in that proceeding contended to the Commission that the Commission should not rule on CBOE's filing until the Delaware court had decided the state law issues. CBOE opposed this, arguing that that the Commission had exclusive jurisdiction over its rule filing to provide an interpretation of a membership rule, and that the Commission should not delay approval of that rule filing while issues of state law were being litigated.[6] The Commission agreed with CBOE and approved the rule filing.[7] This establishes a clear precedent: the Commission will decide whether a proposed rule change complies with the Act, without delay, while a state court decides separate issues of state law. The principle that CBOE argued for in 2007 should be applied now. The Commission should approve ISE's rule filing without regard to the Illinois proceedings, which involve separate and distinct issues of intellectual property law and state procedure, and have nothing to do with the requirements of the Act.

CBOE and S&P are wrong in another respect. As ISE's rule filing makes clear, the proposed options on the ISE Max SPY™ Index are very clearly not options on the S&P 500® Index, and thus are not violative of an existing injunction. The rule filing makes clear that the ISE Max SPY™ Index is calculated based on the traded prices of SPDR® S&P 500® ETF Trust ("SPY ETF") shares, and that settlement of the options are settled on the basis of a calculation of the net asset value ("NAV") of the SPY ETF trust's assets. CBOE's and McGraw-Hill's primary basis for claiming otherwise is a single, erroneous sentence contained in ISE's 50 page rule filing. This single, erroneous sentence is contained in the basis section of ISE's rule filing, which section is not controlling in terms of the description of the product. CBOE and S&P conveniently ignore tens of pages of description of the product in the purpose section of ISE's rule filing (which section is controlling in terms of the description of the product), which very clearly and expressly indicate that options on the ISE Max SPY™ Index are as described above and are not options on the S&P 500® Index. Nevertheless, to correct this erroneous sentence and remove any ambiguity, ISE has today filed an amendment to its rule filing which replaces that erroneous sentence.

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[6] Letter from CBOE submitted in response to comments received in relation to SR-CBOE-2006-106, dated June 15, 2007.
[7] Securities Exchange Act Release No. 57159 (January 15, 2008), 73 FR 3769 (January 22, 2008) (Order Approving SR-CBOE-2006-106).

ISE Will Not Commence Trading Options on ISE Max SPY™ Index until the Illinois Court has Ruled on the Motion

CBOE states that significant market disruption and harm to investors could occur if the SEC were to approve the proposed rule change prior to the Illinois state court ruling on the Motion. ISE disagrees that the SEC's approval of this filing prior to the Illinois state court ruling on the Motion would result in either significant market disruption or harm to investors. Nevertheless, ISE represents that, absent returning to the Commission and seeking explicit approval to do so, it will not commence trading options on the ISE Max SPY™ Index until the Illinois state court has ruled on the Motion. Accordingly, since there will be no trading in the proposed options without Commission approval before a ruling on the Motion, there is no opportunity for market disruption or harm to investors, and therefore such claims are moot.

There is Nothing that is Inaccurate or Misleading about ISE's Description of Options on the ISE Max SPY™ Index: The Settlement Methodology is Clear and Unambiguous.

The CBOE Letter is replete with numerous attacks on various aspects of ISE's settlement methodology for options on the ISE Max SPY™ Index. Again, these blatant attacks are nothing more than smokescreens, designed to create confusion and suggest ambiguity where there is none. The settlement methodology proposed by ISE is clear, unambiguous, and legally-sound. Notwithstanding, ISE addresses CBOE's points below.

ISE's Proposed Settlement Calculation Methodology is Appropriate

CBOE asserts that the benchmark (that is, the ISE Max SPY™ Index) is in fact not based on the SPY ETF, because the settlement values of the proposed options are not actually settled by reference to the value of the SPY ETF. That assertion is, at best, confused, and at worst, inaccurate or misleading. While ISE is clearly not taking the closing price of the SPY ETF and multiplying that by ten (10) to achieve the settlement value for the index, the ISE Max SPY™ Index most certainly is settled by reference to the value of the SPY ETF. ISE is independently calculating the NAV of the SPY ETF using a methodology that closely tracks the methodology that State Street Global Advisors ("SSGA") uses to calculate the NAV of the SPY ETF. ISE is doing so (1) to decrease the opportunity for manipulation and other abusive trading practices, and (2) to allow for a timely settlement of the proposed options.

As well, the concept of utilizing a reference price to settle an index option product that differs from the values of the proposed benchmark is not novel, and is best illustrated in CBOE's AM-settled S&P 500® index options. That product uses a settlement value calculation called the Special Opening Quotation ("SOQ"). The SOQ is a special calculation of the underlying index, in that case the S&P 500®, where the opening prices of the individual index components are used to determine the settlement of options contracts. It is important to note that component stocks may open seconds, minutes, hours, or not at all, after the primary markets have opened. This can result in a settlement value that has a significant discrepancy from the initial index quote, especially when the market experiences short-term accentuated volatility, so-called market gaps. Thus, the concept of utilizing a reference price for settlement of options that differs from the benchmark values is an established practice that CBOE itself has followed for many years.

As well, the SOQ process could be misleading when compared to current actionable prices of the index components. This settlement value calculation method results in significant uncertainty with respect to the timing of the settlement value being established. Since the SOQ is based on the opening prices of the index components, the settlement value may be disseminated well into the trading day or perhaps even at the close of trading. The proposed settlement value for ISE Max SPY™ Index, on the other hand, will always be established after the primary markets close on the last trading day of the expiring contract. Nevertheless, the concept of utilizing a reference price for settlement that differs from the benchmark values is an established practice.

In determining how best to settle options on the ISE Max SPY™ Index, ISE decided to independently calculate the NAV of the SPY ETF rather than utilize the SSGA-calculated closing value of the SPY ETF. ISE believes its chosen method would make it more difficult to manipulate the settlement price of ISE Max SPY™ Index. Under ISE's proposed methodology, a would-be manipulator would need to manipulate the closing price of 500 individual stocks, which would require the would-be manipulator to take on broad exposure to hundreds of highly liquid, highly capitalized stocks held by the SPY ETF. In contrast, if ISE used the closing price of the SPY ETF as its settlement value, a would-be manipulator would only need to manipulate the closing price of one ETF. Accordingly, ISE believes its chosen settlement methodology is less prone to manipulation than the manner CBOE suggests.

Further, the obligation of SSGA, the trustee of the SPY ETF, is to establish a NAV of the SPY ETF before the next day's opening. Since OCC requires settlement values to be sent to it the same day as the settlement of the option, ISE cannot rely on the SSGA-published NAV number (as it might not be available in time), but rather must calculate the NAV of the SPY ETF on its own in order to meet this deadline and ensure a timely settlement of the proposed options.

Given that ISE must calculate the NAV itself, ISE is employing a well-known methodology that is intended to track, as closely as possible, SSGA's methodology for its calculation of the NAV for the SPY ETF. As the term implies, the NAV is a method for determining the value of the trust on a per share basis. Indeed, the creation and redemption of trust units (shares of SPY) are made using the trust's NAV. While ISE's NAV calculation may contain different prices for the portfolio securities (since the trustee reserves the right to evaluate portfolio securities independently of closing sale prices of those securities if it deems such prices to be "inappropriate"[8]), the method of calculating an ETF's NAV is generally the same.

ISE Clearly Describes the Assets that are Taken into Account when Calculating the Settlement Value

Additionally, CBOE claims that the ISE rule filing is unclear in describing the assets that ISE would take into account when calculating settlement values. This is another obvious smokescreen. Generally, the NAV calculation on a per share basis for equity-based ETFs is calculated in the same manner, regardless of who the calculation agent is. It is a well-known industry standard for equity-based ETFs. The NAV is determined by adding the value of the portfolio securities and the trust's net cash (accrued dividends minus accrued fees and expenses), and dividing the result by the total number of outstanding shares of the fund. The net cash amount is usually determined by the fund's administrator,[9] who provides that information to the National Securities Clearing Corporation ("NSCC"). Market participants may obtain that information from the NSCC. Thus, there is no ambiguity in which assets ISE would take into account when calculating the settlement value.

ISE Clearly Describes the Source of Prices used to Calculate the Settlement Value

CBOE similarly argues that ISE's rule filing is unclear in describing the source of the prices that ISE would use in calculating settlement values and does not explain why settlement values would be calculated differently. However, the source of the prices for the portfolio securities of the trust was clearly identified in ISE's rule filing.[10] ISE states that it uses the published closing prices from the

[8] SPDR Prospectus, Page 67.
[9] State Street Bank and Trust Company is the Trustee of the SPDR Trust. SPDR Prospectus, Page 3
[10] See footnote 3 of SR-ISE-2012-22.

primary market of those securities. CBOE's assertion that ISE's representation is inconsistent with the SPDR prospectus is also not accurate. This is because the trust may independently decide which exchange it deems to be the "primary market" as a source for closing prices. CBOE incorrectly assumes to know how the trust makes that determination. Nevertheless, there is nothing unclear or uncertain about the source of prices that ISE would use for the ISE Max SPY™ Index settlement value.

Special Dividends and Extraordinary Distributions

CBOE further argues that ISE's rule filing is unclear in describing how a special dividend or other extraordinary distribution would be assessed. However, it has never been a practice of the exchanges to describe, in their index option approval-seeking rule filings, details on dividend processing for components of those indexes. Further, because the proposed product is an index option, the Exchange does not anticipate adjustments being made to the options as a result of any component dividends. This is customary practice for index options.

An Index with One Component is Still an Index

CBOE argues that even if the proposed benchmark could be said to have reference to SPY ETFs, the benchmark would have only one component security and therefore would simply not be an "index." Again, this is nothing more than a self-serving, conclusory statement by CBOE that lacks any legal basis and is, in fact, contrary to existing precedent, both in terms of SEC-approved CBOE rules and CBOE products.

CBOE applied to the Commission, and received approval, for the listing and trading of Micro Narrow-Based index options whereby a qualifying index must have nine or fewer component securities.[11] Indeed, these rules allow for options that focus on indexes having very few components (i.e., one to nine). Thus, CBOE's assertion that an index having only one component is not an index is contradictory to its own SEC-approved rules that permit the listing and trading of options on an index that could have only one component.

Further, CBOE maintains indexes that measure the spot yield of individual U.S. Treasury Securities (for example, symbol TNX's values as based on the 10-year Treasury note) by simply multiplying them by 10. Those indexes were once used as underlying references for CBOE's Interest Rate Options.[12] Although CBOE has subsequently delisted its Interest Rate Options, it still calculates and

[11] CBOE Rulebook, Chapter XXIV, 24.2(d).
[12] CBOE Rulebook, Chapter XXIII.

disseminates the values to major market data vendors, brokers, and other market participants that refer to them as indexes. The industry, in general, has no concern with labeling them "indexes" simply because they are based on a modified value of a single component. Thus, CBOE's own rules and practices make clear that this assertion is without merit.

Supplements to the Options Disclosure Document, or ODD.

There is a well-settled process for supplementing the ODD in connection with the launch of a new option product by an exchange. This process, which is mandated and described in Section 28 of the Restated Participant Exchange Agreement among OCC and all participant exchanges, requires all necessary disclosures to be jointly prepared by OCC and the exchanges. Specifically, Section 28 created the Listed Options Disclosure Committee ("LODC"), which is comprised of representatives of OCC and each of the participant exchanges, and which has responsibility for determining and performing the necessary disclosure. There is a well-settled process followed by the LODC that is outlined in Section 28, and this process has been used countless times to supplement the ODD to describe risks associated with a new product. There is nothing atypical about the proposed launch of options on the ISE Max SPY™ Index, and ISE reaffirms its contractual commitment to continue to follow the process called for in Section 28 to devise disclosure of any risks associated with the proposed options that are determined by the LODC to be necessary for disclosure. In fact, ISE has been in discussions with OCC on disclosure alternatives for the proposed options for several months now, well in advance of CBOE's comments. This new product will follow the same process as previous new products with respect to the LODC.

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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 and General Counsel