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VIA Electronic Mail

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Release No. 34-63166; File No. SR-NYSEArca-2010-90
(formerly Release No. 34-62580; File No. SR-NYSEArca-2010-69)

Dear Ms. Murphy:

The Chicago Board Options Exchange, Inc. ("CBOE") is submitting this supplemental comment letter in response to the December 20, 2010 letter submitted on behalf of NYSEArca, Inc. ("Arca") regarding its proposal to amend its rules to describe new procedures for executing non-facilitation (regular way) cross transactions (Securities Exchange Act Release No. 63166 (October 22, 2010), 75 FR (SR-NYSEArca-2010-90)).¹ Arca's letter fails to address the issues raised in CBOE's August 26 and November 18, 2010 comment letters and we ask the Commission to disapprove the proposed rule change.²

In our previous letters, we have raised significant and legitimate options market structure concerns about the complete lack of actionable market exposure that would result under Arca's proposed crossing procedure. While we acknowledge that Arca's revision of its original proposal to include a requirement for a Floor Broker to disclose the size of its order would help to make it possible for the trading crowd (and particularly liquidity providers such as market makers) to provide final quotes, Arca has not addressed straight-forward concerns about the fact that the trading crowd would be shut out from these trades (except in two limited scenarios described below) and the detrimental impact this would have on the options markets. There also continues to be a lack of clarity on whether a Floor Broker would be permitted to walk away from the crowd after a request for quote pursuant to the proposed Rule without executing the orders in the broker's custody.

¹ Letter to Elizabeth M. Murphy, Secretary, SEC, from Janet L. McGinness, SVP & Corporate Secretary, Legal & Government Affairs, NYSE Euronext on behalf of Arca (December 20, 2010).

² Letters to Elizabeth M. Murphy, Secretary, SEC, from Jennifer M. Lamie, Assistant General Counsel, CBOE (August 26, 2010 regarding SR-NYSEArca-2010-69 and November 18, 2010 regarding SR-NYSEArca-2010-90).

Arca's response letter states that:

“. . . CBOE claims that market makers effectively would be excluded from participating in any part of a transaction resulting from a request for a final quote. This claim is misleading, attempts to conflate our proposal with other filings, and has no basis in fact. NYSE Arca fully recognizes that its own market is dependent on the quality and liquidity of the markets provided by our market maker community. In return, market makers must compete for order flow through providing competitive quotes. CBOE refuses to recognize or acknowledge that our proposal affords market makers who respond with competitive quotes the opportunity to provide price discovery and participate in a Floor Broker cross effected under the terms of the proposed rule change.”

Frankly, we find Arca's response (or lack there of) perplexing. If the broker can only cross the orders at prices better than the crowd's final quote, then, by definition, the crowd cannot participate in the cross transactions. We have raised concerns that the inability of the crowd to participate in resulting transactions would render any exposure meaningless and would create a disincentive for the crowd to provide a final quote in the first place. *Arca has not responded to these concerns as well as concerns about the detrimental impact the proposal would have on the options markets.* Arca has also not responded to questions of how shutting out the crowd is consistent with longstanding options market precedent and policy regarding crossing and exposure nor provided justification for deviating from these principles. Further, Arca has not explained how it believes the proposal affords market makers a full and fair opportunity to provide price discovery and participate on a cross - simply making a declarative statement does not make it so.

Instead, Arca seems to somehow be claiming that commenters are misunderstanding the mechanics of how their proposed crossing procedure would operate. Therefore, before getting to substantive policy considerations and discussion on whether there is an adequate basis for approval of the proposal under the Exchange Act, it seems reasonable to confirm we are on the same page about the factual attributes of Arca's proposal.

CBOE understands the proposal to operate as follows:

- The proposed rule change would allow a Floor Broker to request, after revealing the size of the orders to be crossed, a final quote from the trading crowd and then, according to the proposed rule text:

“. . . the Floor Broker must bid above the highest bid in the crowd, or offer below the lowest offer in the crowd by at least the [minimum price variation ('MPV')]. Once the Floor Broker has revealed the price at which he intends to cross the orders, Market Makers, and Floor Brokers holding discretionary orders, may not improve upon their previously vocalized bids and offers.”

See existing and proposed changes to text of Arca Rule 6.74(a) (emphasis added).³

- The proposal indicates that a cross could only take place at the crowd's final quote price in two limited scenarios. Specifically, the Arca proposal states that the two scenarios are as follows:

"If . . . the final quote was only one MPV wide, (*i.e.*, 3.10 bid for 20 contracts at 3.20 offer for 50 contracts) the Floor Broker could not meet the obligation to the orders without trading on a final quote price. In this case, the Floor Broker would bid above the final quote bid (*i.e.*, bid 3.20) or offer below the final quote offer (*i.e.*, offer at 3.10), each instance of which is equal to a final quote price. The Floor Broker would then be obligated to trade with the final quote interest at that price (*i.e.*, buy 50 at 3.20 or sell 20 at 3.10) before crossing the balance of the orders.

Additionally, if, because of movement in the markets while the order was being brought to the crowd, the limit on one of the orders only allowed for a cross to be effected at a final quote price, regardless of the width of the final quote, the Floor Broker would be required to bid above the final quote bid or offer below the final quote offer yet still be at a final quote price. Again, the Floor Broker would be obligated to trade with the final quote interest at that price before crossing the balance of the orders. For instance, the electronic market in the series is 3.00 bid offered at 3.30, and the Floor Broker receives orders to cross at 3.10 or 3.20. When the Floor Broker requests a Final Quote, the crowd responds with a market of 3.20 bid at 3.30. In order to meet the obligation to execute the order, the Floor Broker would have to offer at 3.20, fill the bids in the crowd at 3.20, and then cross the balance of the orders."⁴

See discussion in purpose section of the proposal, Securities Exchange Act Release 63166, 75 FR at 66407 – 66408.

Based on our reading of the foregoing, we believe Arca's proposed crossing procedure results in a shut out of the trading crowd (except in the two limited scenarios noted above). Based on our reading, we fail to see how our prior comments on the proposal in any way

³ The proposal also provides that (i) the execution price must be equal to or better than the NBBO, and (ii) the Floor Broker may not trade through any bids or offers on the Book that are priced equal to or better than the proposed execution price. If there are bids or offers on the Book at or better than the proposed execution price, the Floor Broker must trade against such bids or offers in the Book. Once bids or offers in the Book are satisfied, the Floor Broker may cross the balance of the orders, if any, to be crossed. The orders will be cancelled or posted in the Book if an execution would take place at a price that is inferior to the NBBO. Id.

⁴ We believe the example could be explained more clearly by providing the specific limit prices for the orders.

mislead, conflate Arca's proposal with other filings, or have a lack of basis in fact. We fail to see how Arca's proposal affords market makers who respond with competitive quotes (assuming they would even bother since the trade cannot seemingly occur on their market) with the opportunity to participate in a Floor Broker cross effected under the terms of the proposed rule change. If something else applies or our facts are off, it would be helpful to the evaluation of the proposed rule change if Arca explained and provided adequate justification for approval under the Exchange Act. To the extent any ambiguities in the filing are clarified, we believe additional opportunity to comment should be offered.

Again, as we have stated in our prior comment letters, the proposed rule change - even as modified to reveal order size - is inconsistent with policy and precedent on crossing orders and it should not be approved. We remain concerned about the harmful impacts the proposal could have on the options markets. In particular:

- The options exchanges' rules are generally designed to balance the desire to permit crosses with the preservation of important order exposure principles, which foster competition, liquidity, transparency and price discovery. If orders are not exposed in a meaningful way and the trading crowd is disadvantaged in competing for an option order in the auction process, it may result in less competition and worse prices for customers. This inequitable outcome is avoided by providing the options trading crowd with a fair and full opportunity to make informed trading decisions and to compete on filling options orders with the Floor Brokers representing the orders to be crossed. If this fair and full opportunity is not provided, the execution of the orders would not be consistent with exchange rules that are designed to promote order interaction.
- Because the trading crowd would be effectively shut out from participating on all non-facilitation crossing transactions, there would be no incentive for the trading crowd to even provide a final quote. Having no incentive to provide competitive quotes - much less no opportunity to trade - would have an adverse impact on market makers' ability and willingness to provide liquidity to the markets and on options market liquidity, transparency and price discovery as a whole. The inability to participate would operate as a clear disincentive. It is unreasonable and counterproductive to ask the trading crowd to provide final quotes when they would generally not be permitted to participate on a trade. This inability to participate would render any exposure - even with the order size - meaningless.
- The proposed procedure amounts to allowing a Floor Broker to execute a "clean cross" inside the quoted market without meaningful exposure or opportunity for price improvement, a practice that has not been permitted in the options markets and should not be permitted now.⁵

⁵ Currently, the only limited exception involves a public customer to public customer cross - since public customers have traditionally maintained order priority over all other market participants, there is a justification to not expose the cross to other participants who would not have priority over public customers anyway. Importantly, these customer-to-customer crosses are only permitted as long as, among other things, the orders are priced in the standard increment and will not trade through the NBBO or at the same price ahead of resting public customer orders. We note that, apart from the instant Arca proposal, the International Securities Exchange ("ISE") has submitted two rule changes to introduce unimpeded crossing, without any exposure whatsoever, for the options leg of a qualified contingent trade, which ISE refers to as the "qualified contingent cross" or "QCC." CBOE has submitted separate

Arca's proposed rule could potentially be used for every options solicitation (and other regular way crosses), which would be detrimental to options market competition, liquidity, transparency, price discovery and ultimately customers. Execution entitlements in the options industry have generally been limited by the SEC to a maximum of 40% when there is other trading interest at the proposed execution price (and only after exposure). Any crossing procedure such as Arca's proposal that would allow for a 100% crossing entitlement, if even permitted at all, should be carefully considered. To the extent that any crossing entitlements have been permitted in the options industry, they have generally contained limitations on minimum order size, required Floor Brokers to stand ready to execute the entire size of the order within certain price parameters, imposed exposure requirements that provided opportunities for price improvement and trading crowd participation, and been subject to other conditions and requirements. By contrast, Arca's modified proposal – which would shut out the trading crowd and permit a clean cross for any sized order – does not contain many of these conditions and requirements nor does it provide adequate explanation or justification for not having the conditions and requirements.

- If the SEC is contemplating a change to past policy and precedent as significant as the Arca proposal represents, we do not believe the change should come in the form of a rule change that would cut away from the policy without any discussion or analysis justifying the change (or without providing a genuine opportunity for comments responsive to any such discussion and analysis). Moreover, if such a change were ultimately approved, we believe there should at least be a notable minimum size limitation and meaningful exposure requirements.
- The SEC should seriously consider the harmful impact the modified proposal would have on the options markets. The inability to participate on crossing transactions would work as a disincentive to quote competitively and provide liquidity on exchanges. This would be harmful to the market because it will remove a valuable incentive for dedicated liquidity provider participation – something that is increasingly viewed by most as critical in light of market events of May 6, 2010. Indeed, to move forward with the proposal in its present form seems contrary to other post-May 6 initiatives designed to bolster liquidity.
- We are concerned that the proposed rule change will have an adverse impact on competition, liquidity, transparency and price discovery for all order sizes, whether represented inside or outside the crossing procedure. We are also concerned the proposed rule change would impose an unreasonable burden on intermarket competition and that other options markets – both open outcry and electronic - will be forced to respond with similar programs, which ultimately would be detrimental to the options markets and customers.

Beyond failing to address the lack of participation by the trading crowd, Arca's modified proposal also fails to address other concerns raised in our prior comment letters. In particular, we continue to question whether or not the proposed procedure should say that a Floor Broker

comment letters objecting to the ISE proposals, primarily noting that the lack of exposure is inconsistent with policy and precedent and the potential detrimental impact such a proposal would have on the options markets. See SR-ISE-2010-73 and SR-ISE-2009-35 and related CBOE comment letters.

shall be obligated (as opposed to may) to proceed with an execution once the Floor Broker receives a final quote from the trading crowd. It remains unclear under the modified proposal whether a Floor Broker has the flexibility to trade on another market at the best price provided from the trading crowd (or at the improved price at which the Floor Broker would have been obligated to execute the cross had the order been executed on the Arca market). Also, in the case where the Floor Broker decides to trade on another market, the order itself is not being cancelled.

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Consistent with the comments provided above, CBOE respectfully requests that the Commission not approve Arca's proposed rule change. Should you have any questions regarding this letter, please contact Joanne Moffic-Silver, General Counsel, at 312-786-7462, Jennifer Lamie, Assistant General Counsel, at 312-786-7576, or me at 312-786-7310.

Sincerely,



Edward J. Joyce
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cc: Robert W. Cook, Division of Trading and Markets
James A. Brigagliano, Division of Trading and Markets
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