INTERNATIONAL SECURITIES EXCHANGE.

60 Broad Street, New York, NY 10004
TEL: 212-943-2400
FAX: 212-425-4926
www.ise.com

December 3, 2009

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-2009-35

Dear Ms. Murphy:

We submit this letter in support of the above-referenced rule filing, in which the International Securities Exchange, LLC ("ISE") proposes to adopt a Qualified Contingent Cross ("QCC") Order. After a full notice and comment period,[1] the Commission's Division of Trading and Markets ("Division") approved the proposal on behalf of the Commission by delegated authority.[2] However, this approval was automatically stayed by a petition submitted by the Chicago Board Options Exchange, Incorporated ("CBOE") requesting review of the filing by the full Commission.[3]

The ISE submitted a letter that addressed two comment letters received by the Commission prior to the approval of the proposal.[4] The ISE also submitted two briefs in support of its motion to lift the automatic stay that was imposed by the petition for review.[5] The ISE believes that these three submissions, which are hereby incorporated by reference, fully address all of the issues raised by the commenters and provide the basis needed for the Commission to confirm the Division's approval of our QCC proposal. However, because there are strong competitive interests that seek to cloud the discussion with inaccurate statements and unsupported conclusions – and without statutory basis – we believe it is important to provide the Commission with a clear and concise statement of facts. Discussion supporting these facts is summarized in the endnotes.

FACT:	**QCC is a narrowly-crafted rule for large-size contingency orders.**

QCC does not open a "Pandora's Box" in the options market that will have wide-spread implications for all orders, options market structure or customer protection. Rather:

[1] Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009) (Notice for ISE-2009-35).
[2] Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009) (Approval Oder for ISE-2009-35).
[3] Letter from Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated September 14, 2009.
[4] Letter from Michael J. Simon, Secretary and General Counsel, ISE, dated August 20, 2009.
[5] Brief in Support of International Securities Exchange, LLC's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by Chicago Board Options Exchange, Incorporated's Notice of Intention to petition for Review, September 11, 2009; and Reply Brief in Support of International Securities Exchange, LLC's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by Chicago Board Options Exchange, Incorporated's Notice of Intention to petition for Review, September 22, 2009.

- QCC is limited to orders of least 500 contracts and must be part of a qualified contingent trade (i.e., tied-to-stock);

- A QCC can only be executed at or between the national best bid and offer (“NBBO”); and

- QCC addresses the mechanics of executing the stock and options components of a net-price transaction in disparate markets with different execution rules, different trading increments and different intermarket trade-through provisions.[i]

The Commission has long recognized disparate treatment for certain orders based on size, contingency or market participant.[ii] There is no legal or logical basis for commenters to assert that if the Commission confirms the approval of QCC based upon the merits of the proposal, the Commission would then have no choice but to approve similar proposals that relate to smaller-size orders or orders without contingencies. If such proposals are to follow, the Commission should evaluate each on its merits.

FACT:	***QCC will have no impact on market quality or customer protection.***

Opponents of the QCC argue that the proposal represents a fundamental change to the options industry that will have broad negative effects on transparency, customer protection, price discovery and liquidity in listed options. This is not the case:

- QCC will have no impact on the options market, as these large-size contingency orders are being executed on the floor-based exchanges today in a manner that is very similar to the QCC proposal;

- QCC will not harm customers; the CBOE is disingenuous is arguing otherwise in the context of QCC while simultaneously arguing with respect to flash orders that there are very few resting customer limit orders in the options market place; furthermore, the customer orders that are on the ISE limit book have no opportunity to interact with these large-size contingency trades today;[iii]

- QCC will not encourage greater off-exchange negotiation of transactions, as these trades are being negotiated off-exchange today;[iv]

- QCC will not discourage quote competition, as these trades are being “printed” without meaningful transparency or market interaction today;[v]

- QCC will not result in worse prices for investors, as they are one component of a net price transaction that must be executed at or between the NBBO.[vi]

FACT:	***QCCs permit fair competition between floor-based and electronic options exchanges for large-size contingency trades.***

The opponents to the QCC are disingenuous with respect to how the QCC might harm the options market. However, it is true that the QCC could have a significant impact on the options market – but in a positive sense – by providing an all-electronic execution alternative to floor-based executions. Today the execution of virtually all large-size orders that are tied to stock are done on the floor-based exchanges, where a high percentage are reported at prices that appear to trade through the NBBO even though the distributive linkage rules prohibit such executions.[vii] The QCC proposal recognizes the realities of why virtually all of these orders are executed on the floor and offers an electronic alternative that assures compliance with the distributive linkage rules:

- The crossing of large-size contingency orders on a floor today is not transparent because there are very few traders (if any) on the floor to hear an order "announced" and the orders are not disseminated electronically to any market participants;

- The crossing of large-size contingency orders on a floor today does not result in price discovery or meaningful price improvement; and

- The crossing of large-size contingency orders on a floor today is accomplished with little, if any, interruption.

The Commission cannot ignore the stark evidence that virtually all large-size contingency orders are executed on the floor-based exchanges. The market itself provides the proof that the current regulatory approach does not promote fair competition:

- Continuing to recognize the "announcement" of a large-size contingency order on a non-responsive trading floor (and allowing a member to withdraw a potential trade from the floor and take that trade to another exchange if there is any actual competition for the order), while requiring all-electronic exchanges to broadcast the same orders to all market participants, ignores the practical differences between the markets;

- Applying a policy to both floor-based and electronic exchanges that is consistent on its face, but that has vastly different results, is not fair competition under the Securities Exchange Act of 1934 ("Exchange Act"); and

- In the absence of tangible customer protection or market integrity issues, the Commission must not impede fair competition.

The reason QCC has invoked industry attention is because it threatens to undermine the economic viability of maintaining floor-based trading franchises and because it threatens a protected revenue stream for those exchanges that maintain floor-based trading. All of our competitors have adopted electronic trading models that compete with us, but some also maintain trading floors within a hybrid model:

- Hybrid trading models should exist for valid trading reasons and not because floor-based trading is a "grandfathered" business that is protected by inequitable regulatory policies;

- Cries that other markets will be forced to adopt similar rules really mean that hybrid exchanges will no longer be able to exclusively keep this large-size crossing business on their floors because they will be forced to compete electronically; and

- If floor-based executions truly provide value to customers, then they will be able to compete with QCC.

* * *

We urge the Commission not to be swayed by the baseless claims of those that reap the financial benefits of the current anti-competitive landscape. Opening competition for large-size contingency trades is good for the market because it encourages efficiency and price competition. Therefore, the Commission should affirm the Division's approval of our QCC proposal.

Sincerely,

Michael J. Simon
Secretary

[i] **QCC addresses execution mechanics.** Because the equity component of a stock-option order can be executed at any price under the Qualified Contingent Trade exemption from Regulation NMS, the pricing of the options component can be flexible. Indeed, whether the options component is executed at or between the ISE BBO is not material because, in most cases, the stock trade can be executed at a price that achieves the desired net price. *See* ISE letter dated August 20, 2009, at footnote 5. However, when the quotation spread is at the minimum increment there cannot be an execution between the ISE BBO. Therefore, we propose to permit an execution of the options component at a price that matches the ISE BBO. We see no regulatory or policy reason why the options component of a stock-option order should be prevented from being executed in such situations.

[ii] **Exceptions to priority rules**: There are numerous examples of exceptions to rules that are made to accommodate specific trading strategies. The Commission provided trade-through relief from Regulation NMS for Qualified Contingent Trades, and the existing rules of the options exchanges permit the execution of one leg of a complex trade at the same price as public customer orders on the limit order book if another leg of the order is executed at an improved price. E.g., CBOE Rule 6.45A. There is no basis under the Exchange Act to assert that an exchange cannot adopt market structures and priority rules that are tailored to accommodate large-size contingent orders, nor that public customer priority must be applied in all circumstances.

[iii] **No customer harm – liquidity issues.** In the options market, most quotes on options exchanges are provided by professional market makers, not customers. See, e.g., CBOE Comments on File No. S7-21-09 (Flash Orders), dated November 18, 2009. The suggestion that allowing QCCs to execute ahead of customers will somehow deprive resting customer limit orders on the book from vital liquidity is not correct. Because the large-size contingency trades that qualify for the QCC under the proposal are almost exclusively executed on the floor exchanges, the occasional customer order resting on the ISE's book at the best bid or offer currently has no opportunity to interact with them. It is the market maker quotes that provide liquidity in the options market, not these large-size contingency trades.

[iv] **No increase in off-exchange negotiation of trades.** QCC is not about creating trading interest that does not exist today, but rather about where the existing trades are executed. There is no basis to believe that there will suddenly be more customers placing large-size contingency orders because they can be executed on the ISE rather than one of the floor based exchanges. Market participants who facilitate these types of transactions today have no problem obtaining an execution on the floors through their existing relationships. QCC

simply provides an all-electronic alternative to executing these types of trades, in competition with the current floor-based monopolies today.

[v] **No meaningful transparency on floors**. There is no requirement that information regarding orders announced on a floor be provided electronically to all exchange member or the public. Indeed, the CBOE recently stated that floor brokers "engage in liquidity and price discovery discussions that do not necessarily involve divulging the material terms of the orders they represent. Eventually those terms are made known in connection with consummating a trade, but the orders are not 'flashed' in the same sense as flash trading." CBOE Comments on File No. S7-21-09 (Flash Orders), dated November 18, 2009, at page 10. So while the CBOE argues on the one hand that ISE should be required to essentially "flash" QCCs before executing them, on the other hand it strives to protect the lack of transparency on its floor. CBOE and the other floor based options exchanges also eliminated the requirement that market makers have a physical floor presence several years ago, further undermining their claim that price discovery and transparency occurs on the trading floor.

[vi] **No customer harm – price issues.** Market participants negotiate stock-option orders on a "net price" basis, that is, a price that reflects the total price of both the stock and options legs of the trade. Once the parties have agreed to a net price, the options component and stock component are executed separately in the options and equity markets. Thus, the actual execution price of each component is not as material to the parties as is the net price of the transaction.

[vii] **High rate of trade-throughs on floors**. Since the implementation of distributive linkage, the bulk of the large-size contingence order business that had been on the ISE moved to floor-based exchanges, particularly NASDAQ OMX Phlx ("Phlx"). At the same time, the quality of these executions has deteriorated, with a high percentage of these large-size orders being reported at prices that trade through the NBBO. For the period September 1, 2009 through November 18, 2009, over 40 percent of the trades of 5000 or more contracts executed on the Phlx were reported at prices that traded-through the NBBO. During the same time period, almost 8 percent of the trades of 5000 or more contracts executed on the CBOE were reported at prices that traded-through the NBBO These trade-through percentages exclude trade-throughs which were reported as Intermarket Sweep Orders and spreads that were exempt from the trade-through rule. While some small percentage of the apparent trade-throughs are simply due to fluctuations in the NBBO between the time of execution and the time the trade was reported, time delays do not explain such high trade-through rates. In comparison, on the all-electronic ISE, time differences between executions and trade reporting resulted in an apparent trade-through rate of only 1 percent over the same time period.