of the Commission (Public Representative) to represent the interests of the general public in this proceeding.

3. Comments by interested persons in this proceeding are due no later than March 3, 2011.

4. The current contract filed in Docket No. CP2010–22 for International Business Reply Service Competitive Contract 2 is authorized to continue in effect through March 31, 2011.

5. The Secretary shall arrange for publication of this order in the **Federal Register**.

By the Commission.

Shoshana M. Grove,

Secretary.

[FR Doc. 2011–4684 Filed 3–1–11; 8:45 am]

BILLING CODE 7710–FW–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 63954; File No. SR–ISE–2009–35]

Securities Exchange Act of 1934; In the Matter of Chicago Board Options Exchange, Incorporated, 400 South LaSalle Street, Chicago, IL 60605; Order Setting Aside the Order by Delegated Authority Approving SR–ISE–2009–35 and Dismissing CBOE's Petition for Review

February 24, 2011.

On June 15, 2009, the International Securities Exchange, LLC ("ISE") filed a proposed rule change with the Commission seeking to establish a Qualified Contingent Cross ("QCC") Order. The proposed rule change was published for comment on June 26, 2009.[1] On August 28, 2009, the Commission approved, by authority delegated to the Division of Trading and Markets, the proposed rule change ("Approval Order").[2] On September 4, 2009, the Chicago Board Options Exchange ("CBOE") filed a notice of intention to file a petition for review of the Approval Order and, on September 14, 2009, CBOE filed a petition for review with the Commission ("Petition for Review"). Under the Commission's Rules of Practice, the filing of CBOE's Petition for Review automatically stayed the Approval Order.[3] On September 11, 2009, ISE filed a motion to lift the automatic stay. On November 12, 2009, the Commission granted CBOE's Petition for Review and denied a motion filed by ISE to lift the automatic stay.[4]

On March 17, 2010, the Commission approved the placement in the public file of a memorandum by its Division of Risk, Strategy, and Financial Innovation ("RiskFin") analyzing certain data relating to ISE's proposed rule change ("RiskFin Memo"). At the same time that the Commission approved placement of the RiskFin Memo in the public file, the Commission also issued an order extending the time to file statements in support of or in opposition to the Approval Order to give the public an opportunity to review the data and analysis in the RiskFin Memo.[5]

On July 14, 2010, ISE filed a new proposed rule change to modify the requirements for QCC Orders (file number SR–ISE–2010–73). The Commission published for public comment the modified proposal.[6] Also on July 14, 2010, ISE submitted a letter requesting that the Commission vacate the Approval Order concurrently with the approval of the new proposed rule, SR–ISE–2010–73.[7]

We have determined to construe ISE's request as a petition to vacate the Approval Order pursuant to Commission Rule of Practice 431(a), which permits us to "affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, any action made pursuant to" delegated authority.[8] We find that, in light of the filing of ISE's modified proposal regarding the QCC Orders,[9] it is appropriate to grant ISE's request and set aside the Approval Order. We also find that, given this disposition of the Approval Order, CBOE's petition for review of that order has become moot.

Accordingly, *it is ordered* that the August 28, 2009 order approving by delegated authority ISE's proposed rule change number SR–ISE–2009–35, be, and it hereby is, set aside; and

It is further *ordered* that the petition for review, filed by the Chicago Board Options Exchange on September 14, 2009, of the August 28, 2009 order approving by delegated authority ISE's proposed rule change number SR–ISE–2009–35 be, and it hereby is, *dismissed.*

By the Commission.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2011–4575 Filed 3–1–11; 8:45 am]

BILLING CODE 8011–01–P

[1] *See* Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009).

[2] *See* Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009).

[3] 17 CFR § 201.431(e).

[4] *See* Securities Exchange Act Release Nos. 60988 and 60989.

[5] *See* Securities Exchange Act Release No. 61722.

[6] *See* Securities Exchange Act Release No. 62523 (July 16, 2010), 75 FR 43211 (July 23, 2010).

[7] *See* letter from Michael J. Simon, Secretary and General Counsel, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated July 14, 2010.

[8] 17 CFR 201.431(a).

[9] The Commission has this day issued a separate order approving SR–ISE–2010–73.

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–63955; File No. SR–ISE–2010–73]

Self-Regulatory Organizations; International Securities Exchange, LLC; Order Granting Approval of a Proposed Rule Change To Modify Qualified Contingent Cross Order Rules

February 24, 2011.

I. Introduction

On July 14, 2010, the International Securities Exchange, LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b–4 thereunder,[2] a proposed rule change to modify rules for Qualified Contingent Cross ("QCC") Orders. The proposed rule change was published for comment in the **Federal Register** on July 23, 2010.[3] The Commission received eight comment letters on the proposed rule change[4] and a response letter from ISE.[5]

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 62523 (July 16, 2010), 75 FR 43211 ("Notice").

[4] *See* Letters from Anthony J. Saliba, Chief Executive Officer, LiquidPoint, LLC, to Elizabeth M. Murphy, Secretary, Commission dated, July 30, 2010 ("LiquidPoint Letter 2"); William J. Brodsky, Chairman and Chief Executive Officer, Chicago Board Options Exchange, Incorporated ("CBOE"), to Elizabeth M. Murphy, Secretary, Commission, dated August 9, 2010 ("CBOE Letter 1"); Ben Londergan and John Gilmartin, Co-Chief Executive Officers, Group One Trading, LP, to Elizabeth M. Murphy, Secretary, Commission, dated August 9, 2010 ("Group One Letter 2"); Janet M. Kissane, Senior Vice President—Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated August 9, 2010 ("NYSE Letter 2"); Thomas Wittman, President, NASDAQ OMX PHLX, Inc. ("Phlx"), to Elizabeth M. Murphy, Secretary, Commission, dated August 13, 2010 ("Phlx Letter 2"); J. Micah Glick, Chief Compliance Officer, Cutler Group LP to Elizabeth M. Murphy, Secretary, Commission, dated September 3, 2010 ("Cutler Letter"); Janet L. McGinness, Senior Vice President—Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated October 21, 2010 ("NYSE Letter 3"); and Gerald D. O'Connell, Chief Compliance Officer, Susquehanna International Group, LLP, to Elizabeth M. Murphy, Secretary, Commission, dated October 22, 2010 ("Susquehanna Letter 2").

[5] *See* Letter from Michael J. Simon, Secretary and General Counsel, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated, August 25, 2010 ("ISE Response").

This order approves the proposed rule change.

II. Background

A. Regulation NMS and Qualified Contingent Trades

The Commission adopted Regulation NMS in June 2005.[6] Among other things, Regulation NMS addressed intermarket trade-throughs of quotations in NMS stocks.[7] In 2006, pursuant to Rule 611(d) of Regulation NMS,[8] the Commission provided an exemption [9] for each NMS stock component of certain qualified contingent trades (as defined below) from Rule 611(a) of Regulation NMS for any trade-throughs caused by the execution of an order involving one or more NMS stocks (each an "Exempted NMS Stock Transaction") that are components of a qualified contingent trade.

The Original QCT Exemption defined a "qualified contingent trade" to be a transaction consisting of two or more component orders, executed as agent or principal, where: (1) At least one component is in an NMS stock; (2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the execution of all other components at or near the same time; (4) the specific relationship between the component orders (*e.g.,* the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since cancelled; [10] (6) the Exempted NMS Stock Transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade; [11] and (7) the Exempted NMS Stock Transaction that is part of a contingent trade involves at least 10,000 shares or has a market value of at least $200,000.[12]

In 2008, in response to a request from the CBOE, the Commission modified the Original QCT Exemption to remove the "block size" requirement of the exemption (*i.e.,* that the Exempted NMS Stock Transaction be part of a contingent trade involving at least 10,000 shares or having a market value of at least $200,000).[13]

B. Background of ISE's Proposal

In August 2009, the Commission approved the Order Protection and Locked/Crossed Market Plan [14] which, among other things, required the options exchanges to adopt written policies and procedures reasonably designed to prevent trade-throughs.[15] Unlike its predecessor plan,[16] the New Linkage Plan does not include a trade-through exemption for "Block Trades," defined to be trades of 500 or more contracts with a premium value of at least $150,000.[17] However, because the New Linkage Plan does not provide a Block Trade exemption, the Exchange was concerned that the loss of the Block Trade exemption would adversely affect the ability of its members to effect large trades that are tied to stock. Accordingly, the Exchange proposed the Original QCC Order (defined below) as a limited substitute for the Block Trade exemption to facilitate the execution of large stock/option combination orders, to be implemented contemporaneously with the New Linkage Rules.

C. SR–ISE–2009–35

1. ISE's Original Qualified Contingent Cross Order Proposal

In SR–ISE–2009–35,[18] ISE proposed a new order type, the QCC Order. The QCC Order as proposed in SR–ISE–2009–35 ("Original QCC Order") permitted an ISE member to cross the options leg of a Qualified Contingent Trade ("QCT") (as defined below) on ISE immediately upon entry, without exposure, if the order: (i) Was for at least 500 contracts; (ii) met the six requirements of the NMS QCT Exemption; and (iii) was executed at a price at or between the national best bid or offer ("NBBO"). Proposed Supplementary Material .01 to ISE Rule 715 defined a QCT as a transaction composed of two or more orders, executed as agent or principal, where: (i) At least one component is in an NMS stock; (ii) all components are effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent; (iii) the execution of one component is contingent upon the execution of all other components at or near the same time; (iv) the specific relationship between the component orders (*e.g.,* the spread between the prices of the component orders) is determined by the time the contingent order is placed; (v) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and (vi) the transaction is fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade.[19]

On August 28, 2009, the Commission approved, by authority delegated to the

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[6] *See* Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

[7] *See* 17 CFR 242.611. An "NMS stock" means any security or class of securities, other than an option, for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan. *See* 17 CFR 242.600(b)(46) and (47).

[8] 17 CFR 242.611(d). See also 15 U.S.C. 78mm(a)(1) (providing general authority for the Commission to grant exemptions from provisions of the Act and the rules thereunder).

[9] *See* Securities Exchange Act Release No. 54389 (August 31, 2006), 71 FR 52829 (September 7, 2006) ("Original QCT Exemption"). The Securities Industry Association ("SIA," n/k/a Securities Industry and Financial Markets Association) requested the exemption. *See* Letter to Nancy M. Morris, Secretary, Commission, from Andrew Madoff, SIA Trading Committee, SIA, dated June 21, 2006.

[10] Transactions involving securities of participants in mergers or with intentions to merge that have been announced would meet this aspect of the requested exemption. Transactions involving cancelled mergers, however, would constitute qualified contingent trades only to the extent they involve the unwinding of a pre-existing position in the merger participants' shares. Statistical arbitrage transactions, absent some other derivative or merger arbitrage relationship between component orders, would not satisfy this element of the definition of a qualified contingent trade. *See* Original QCT Exemption, *supra,* note 9.

[11] A trading center may demonstrate that an Exempted NMS Stock Transaction is fully hedged under the circumstances based on the use of reasonable risk-valuation methodologies. *Id.*

[12] *See* 17 CFR 242.600(b)(9) (defining "block size" with respect to an order as at least 10,000 shares or $200,000 in market value).

[13] *See* Securities Exchange Act Release No. 57620 (April 4, 2008) 73 FR 19271 (April 9, 2008) ("CBOE QCT Exemption"). The current QCT Exemption (*i.e.,* as modified by the CBOE QCT Exemption) is referred to herein as the "NMS QCT Exemption."

[14] *See* Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (File No. 4–546) ("New Linkage Plan"). ISE also proposed revisions to its rules to implement the New Linkage Plan ("New Linkage Rules"). *See* Securities Exchange Act Release No. 60559 (August 21, 2009), 74 FR 44425 (August 28, 2009) (SR–ISE–2009–27).

[15] A trade-through is a transaction in a given option series at a price that is inferior to the best price available in the market.

[16] The former options linkage plan, the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Former Linkage Plan"), was approved by the Commission in 2000 and was operative until August 31, 2009, when the New Linkage Plan took effect. *See* Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (File No. 4–429).

[17] *See* Sections 2(3) and 8(c)(i)(C) of the Former Linkage Plan and old ISE Rule 1902(d)(2).

[18] *See* Securities Exchange Act Release No. 60147 (June 19, 2009), 74 FR 30651 (June 26, 2009) (SR–ISE–2009–35 Notice).

[19] The six requirements are substantively identical to the six elements of a QCT under the NMS QCT Exemption. *See supra* notes 9 and 13.

Division of Trading and Markets, ISE's Original QCC Order proposal.[20] On September 4, 2009, CBOE filed with the Commission a notice of intention to file a petition for review of the Commission's approval by delegated authority [21] and, on September 14, 2009, CBOE filed a petition for review, which automatically stayed the delegated approval of the Original QCC Order.[22] On September 11, 2009, ISE filed a motion to lift the automatic stay.[23] On September 17, 2009, CBOE filed a response to ISE's Motion.[24] On September 22, 2009, ISE filed a reply in support of its motion to lift the automatic stay.[25] In addition to the submissions from CBOE and ISE, the Commission received eight comment letters requesting that the Commission grant CBOE's Petition for Review.[26]

On November 12, 2009, the Commission granted CBOE's Petition for Review and denied ISE's motion to lift the automatic stay.[27] In connection with the Order Granting Petition, the Commission received three statements in support of the Original Approval Order (two of which were submitted by ISE) [28] and five statements in opposition to the Original Approval Order (two of which were submitted by CBOE).[29]

2. Commenter's to ISE's Original QCC Order Proposal

In its Petition for Review and statements in support thereof, CBOE argued that ISE's Original QCC Order proposal was inconsistent with the Act [30] and raised important policy concerns that the Commission should address, including whether crossing straight or complex option orders without exposure is appropriate and whether permitting a "clean" cross in front of public customer orders is appropriate. CBOE believed that ISE's proposal was inconsistent with the Act because "it effectively establishes ISE as a print facility for large options orders rather than an exchange where orders are able to interact in an auction setting." [31] CBOE and certain commenters objected to the Original QCC Order proposal because, for crosses that satisfy the QCC's requirements, a member of ISE could execute a clean cross without exposing the cross to other ISE participants, which CBOE stated would represent a significant change from historical and current market practices in the options markets.[32] CBOE contended that the Commission's policy and practice had been to limit the percentage of the crossing entitlement to an amount below 50% of the order being executed, and then only after ensuring that all crossing entitlements are exposed and yield to public customer orders.[33] CBOE stated that the policies requiring exposure and yielding to public customer interest balance "the desire to permit internalization/solicitations to some degree while at the same time ensuring competition and price discovery and, to some degree, protecting public customers (including retail investors)." [34] Without an exposure requirement, CBOE contended that the proposal would have a major adverse impact on options market structure, and result in a trading environment that is "sluggish, nontransparent, and noncompetitive." [35]

CBOE and many of the commenters to the Original QCC Order proposal believed that the lack of any exposure requirement in ISE's Original QCC Order would have a detrimental effect on the options market as it would provide a disincentive to ISE's market makers to quote competitively, undercut their market making function and could result in market makers migrating off other exchanges that do not offer a QCC Order type to ISE, to take advantage of potentially wider spreads and where greater margins might be available with

[20] *See* Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009) ("Original Approval Order").

[21] *See* Letter from Paul E. Dengel, Counsel for CBOE, Schiff Hardin LLP, to Elizabeth M. Murphy, Secretary, Commission, dated September 4, 2009.

[22] *See* Letter from Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated September 14, 2009 ("Petition for Review").

[23] *See* Brief in Support of ISE's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by CBOE's Notice of Intention to Petition for Review, dated September 11, 2009 ("ISE's Motion").

[24] *See* Response of CBOE to Motion of ISE to Lift Automatic Stay, dated September 17, 2009 ("Response to Motion").

[25] *See* Reply in Support of ISE's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegated Action Triggered by CBOE's Notice of Intention to Petition for Review, dated September 22, 2009 ("ISE Reply").

[26] *See* Letters from Jeffrey S. Davis, Vice President and Deputy General Counsel, NASDAQ OMX PHLX, Inc., to Elizabeth M. Murphy, Secretary, Commission, dated September 22, 2009 ("Phlx Letter"); Gerald D. O'Connell, Chief Compliance Officer, Susquehanna International Group, LLP, to Elizabeth M. Murphy, Secretary, Commission, dated September 30, 2009 ("Susquehanna Letter"); Megan A. Flaherty, Chief Legal Counsel, Wolverine Trading, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated October 2, 2009 ("Wolverine Letter"); Janet M. Kissane, Senior Vice President—Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated October 5, 2009 ("NYSE Letter"); Ben Londergan, Co-CEO, Group One Trading, L.P., to Elizabeth M. Murphy, Secretary, Commission, dated October 5, 2009 ("Group One Letter"); Anthony J. Saliba, Chief Executive Officer, LiquidPoint, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated October 7, 2009 ("LiquidPoint Letter"); Kimberly Unger, Executive Director, The Security Traders Association of New York, Inc., to Elizabeth M. Murphy, Secretary, Commission, dated October 29, 2009 ("STA Letter"); and Peter Schwarz, Integral Derivatives, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated November 25, 2009 ("Integral Derivatives Letter"). In addition, ISE submitted certain market volume and share statistics. *See* E-mail from Michael J. Simon, ISE, to Elizabeth King, Associate Director, Division of Trading and Markets, Commission, dated September 30, 2009.

[27] *See* Commission Order Granting Petition for Review and Scheduling Filing of Statements, dated November 12, 2009 and Commission Order Denying ISE's Motion to Lift the Commission Rule 431(e) Automatic Stay of Delegate Action Triggered by CBOE's Notice of Intention to Petition for Review, dated November 12, 2009 ("Order Granting Petition").

[28] *See* Letters from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated December 3, 2009 ("ISE Statement 1"); from Leonard Ellis, Head of Capital Markets, Capstone Global Markets, LLC, to Elizabeth Murphy, Secretary, Commission, dated December 3, 2009 ("Capstone Statement"); and Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated December 16, 2009 ("ISE Statement 2").

[29] *See* Letters from Joanne Moffic-Silver, Executive Vice President, General Counsel & Corporate Secretary, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated December 3, 2009 ("CBOE Statement 1"); Michael Goodwin, Senior Managing Member, Bluefin Trading, LLC, to Elizabeth M. Murphy, Secretary, Commission, dated December 2, 2009 ("Bluefin Statement"); John C. Nagel, Managing Director and Deputy General Counsel, Citadel, to Elizabeth M. Murphy, Commission, dated December 3, 2009 ("Citadel Statement"); Janet M. Kissane, Senior Vice President—Legal & Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated December 3, 2009 ("NYSE Statement 1"); and Angelo Evangelou, Assistant General Counsel, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated January 20, 2010 ("CBOE Statement 2"). The Commission also received a statement from ISE responding to the CBOE Statement 2 regarding its statistical claim and number of trade-throughs. *See* Letter from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated March 1, 2010.

[30] *See e.g.,* Petition for Review, *supra* note 22, at 11. *See also* CBOE Statement 1, *supra* note 29, at 5–6, 15–16.

[31] *See* Petition for Review, *supra* note 22, at 13. *See also* Bluefin Statement, *supra* note 29; Citadel Statement, *supra* note 29, at 2; and LiquidPoint Letter, *supra* note 26, at 4. *See also* Wolverine Letter, *supra* note 26 and CBOE Statement 1, *supra* note 29, at 8.

[32] *See* Petition for Review, *supra* note 22, at 5, 9, 13–15. *See also* Bluefin Statement, *supra* note 29; Citadel Statement, *supra* note 29, at 2; NYSE Statement 1, *supra* note 29, at 2; Wolverine Letter, *supra* note 26; and LiquidPoint Letter, *supra* note 26, at 2.

[33] *See* Petition for Review, *supra* note 22, at 5, 17. CBOE also noted ISE's investment in an entity that CBOE asserted is "geared towards the non-transparent execution of block size stock-option transactions," which CBOE contended would benefit from the ISE's proposal. *Id.* at 11. *See also* CBOE Statement 1, *supra* note 29, at 13–14.

[34] *See* Petition for Review, *supra* note 22, at 15.

[35] *Id.* at 10, 14. CBOE and some commenters also noted their belief that the lack of exposure also degrades market transparency, which they believe is related to the Commission's concerns relating to dark pools. *Id.* at 16. *See also, e.g.,* NYSE Statement 1, *supra* note 29, at 1, 4.

less competitive quoting.[36] One commenter stated that the Original QCC Order, by preventing market makers from participating in trades occurring at their quoted prices, would cause market makers to spread their quotes wider to increase their profit margins in compensation for the lower volume of trading in which they participate.[37] This commenter further stated that, eventually, such market makers might very well question the wisdom of committing capital to make firm markets in the thousands of options series in which they have continuous quoting obligations.[38] Another commenter noted that, ultimately, this would "increase the costs and decrease the availability of proven, effective risk management through derivatives" and harm options market participants, as their ability "to execute their myriad strategies would disappear."[39] Thus, some commenters believed that permitting the implementation of the QCC Order would harm the growth prospects of the overall options industry.[40]

However, ISE argued that the QCC Order type would not impact the options markets, and that large-size contingency orders are executed on floor-based exchanges in a manner very similar to the new order type proposed by ISE. In addition, ISE noted that there is no meaningful transparency on floors because there is no requirement that information on orders presented to the floor be announced electronically to all exchange members or the public.[41] ISE also noted that some floor-based options exchanges have eliminated the requirement that market makers have a physical presence on the floor, which it believes undermines the claim that price discovery and transparency occur on the trading floor.[42] One commenter to the Original QCC Order proposal agreed and stated that the exposure-related concerns of other commenters "do not adequately recognize the reality of how this business is conducted today and seem to simply endorse a manual trading environment that prevents competition from electronic exchanges."[43]

In addition to CBOE's opposition to the Original QCC Order because of its lack of an exposure requirement, CBOE also argued that public customers that have previously placed limit orders at the execution price of a QCC Order would be harmed because those customers would lose priority and would not receive executions of their resting orders.[44] CBOE expressed concern that, because certain customer orders would not receive priority, the proposal would create a disincentive to placing limit orders.[45] CBOE maintained that, with respect to intra-market priority in the exchange-listed options markets, the long-standing industry policy and practice has been to require public customer priority for simple option orders.[46] Two commenters also expressed concern that the Original QCC Order would cause public customers with existing orders to be disadvantaged in the executions that they receive and would be a direct disincentive to market makers and would likely encourage wider quoted markets.[47]

ISE disagreed with the commenters' claims that public customers with resting limit orders would be harmed by its QCC proposal. ISE stated that large-size contingency trades that would qualify as QCC Orders are currently almost exclusively executed on floor-based exchanges, thus "the occasional customer limit order resting on ISE's book * * * has no opportunity to interact with [such orders]."[48]

In addition, CBOE stated that no execution entitlements have been permitted thus far, unless there is first yielding to public customer interest.[49] CBOE contrasted the Original QCC Order with the rules of all options exchanges relating to net-priced complex orders, which require that each options leg(s) of the complex order trade at or inside the NBBO and, at a minimum, price improve public customer orders in at least one component options leg.[50] CBOE also noted that, in a stock-option order net-priced package, it has been the Commission policy to require that the option leg of the stock-option order either yield to the same priced public customer order represented in the individual options series or trade at a better price.[51] CBOE argued that the Original QCC Order, in contrast, would be given special priority that goes beyond the priority afforded to packaged stock-option orders by permitting it to be crossed without giving priority to public customers.[52]

In response, ISE noted that there are many examples of exception to rules to accommodate specific trading strategies.[53] ISE further argued that there is no basis under the Act to prevent exchanges from adopting market structures and priority rules that are tailored for large-size contingent orders and that customer priority is not required in all circumstances.[54]

Commenters to the Original QCC Order also questioned whether the customer involved in the QCC Order would be able to receive the best price for its order because, without a requirement for the order to be exposed, the submitting member's customer would not have the opportunity to receive price improvement for the options leg of the order.[55] Specifically, CBOE expressed concern that, because the QCC Order would eliminate the requirement of market exposure, the customer whose order is submitted through the QCC Order mechanism might receive a fill at a price that is inferior to the price the customer would have received if the full package or even the options component had been represented to the market.[56]

ISE responded to these concerns by explaining that, when negotiating a stock-option order, market participants agree to a "net price," *i.e.,* a price that reflects the total price of both the options and stock legs of the transaction which are executed separately in the options and equity markets.[57] Accordingly, ISE believed that, for such trades, the actual execution price of each component is not as material to the parties to the trade as is the net price of the transaction.[58]

[36] *See* CBOE Statement 1, *supra* note 29, at 8; NYSE Statement 1, *supra* note 29 at 2, 3; and LiquidPoint Letter, *supra* note 26, at 3, 5. *See also* Petition for Review, *supra* note 22, at 13.

[37] *See* NYSE Statement 1, *supra* note 29 at 3.

[38] *Id.*

[39] *See* LiquidPoint Letter, *supra* note 26, at 3, 5.

[40] *See* NYSE Statement 1, *supra* note 29, at 2 and LiquidPoint Letter, *supra* note 26, at 3–5. *See also* CBOE Statement 1, *supra* note 29, at 8.

[41] *See* ISE Statement 1, *supra* note 28, at 2, 6.

[42] *Id.*

[43] *See* Capstone Statement, *supra* note 28, at 2.

[44] *See* Response to Motion, *supra* note 24, at 4.

[45] *See* Petition for Review, *supra* note 22, at 13.

[46] *Id.* at 17. *See also* CBOE Statement 1, *supra* note 29, at 5, 9.

[47] *See* Bluefin Statement, *supra* note 29 and NYSE Statement 1, *supra* note 29 at 2.

[48] *See* ISE Statement 1, *supra* note 28, at 2, 5.

[49] *See* Petition for Review, *supra* note 22, at 15.

[50] *Id.* at 18.

[51] *Id.*

[52] *Id.* at 19.

[53] *See* ISE Statement 1, *supra* note 28, at 2, 5. For example, ISE pointed to the existing rules of the options exchanges that permit the execution of one leg of a complex trade at the same price as a public customer order on the limit order book if another leg of the order is executed at an improved price. *See* CBOE Rule 6.45A.

[54] *Id.*

[55] *See* CBOE Statement 1, *supra* note 29, at 7–8 and Petition for Review, *supra* note 22, at 13. *See also* Bluefin Statement, *supra* note 29; Group One Letter, *supra* note 26, at 1–2; and Integral Derivatives Letter, *supra* note 26.

[56] *See* CBOE Statement 1, *supra* note 29, at 7.

[57] *See* ISE Statement 1, *supra* note 28, at 2, 6.

[58] *See id.*

3. RiskFin Analysis of Large-Size Contingency Orders

In support of the Original QCC Order, ISE stated that its proposed QCC Order provided an all-electronic alternative to the open-outcry execution of large stock-option trades on floor-based exchanges. While both all-electronic exchanges and floor-based exchanges have rules that require exposure of an order before a member is permitted to trade with such order, ISE believes that the requirement under ISE's rules is significantly more onerous than the similar requirement of floor-based exchanges, where such exchanges are only required to expose such orders to their members on the floor and not electronically to all members. Accordingly, ISE asserted, among other things, that it needed the QCC Order to remain competitive with other exchanges, particularly floor-based exchanges, because although these orders are exposed on the floor-based exchanges, they are rarely broken up.[59]

In order to examine ISE's contention with respect to activity on floor-based exchanges regarding large-sized contingent trades, in October 2009, the Commission's Division of Risk, Strategy and Financial Innovation ("RiskFin") requested Consolidated Options Audit Trail System ("COATS") data from certain options exchanges for each Tuesday in August and September of 2009. On March 17, 2010, RiskFin placed in the public file a memorandum analyzing the COATS data, in which it presented the findings of its analysis of ISE's contention that large-size contingency orders on floor-based exchanges were never or nearly never broken up.[60] The RiskFin Analysis provided some support for ISE's contention that large orders are broken up less frequently on floor-based exchanges than on an electronic exchange, though it did not definitively confirm ISE's contention. Specifically, in examining the percentage of trades that are either fully or near-fully executed against a single contra-party, the RiskFin Analysis showed that, for trades with a size of 2,000 contracts or more, only 12% were completely executed with only one execution on ISE, compared to 26% and 29% of trades that were filled with only one execution on two floor-based exchanges. Similarly, the data also showed that for orders of 2,000 contacts or more, only 16% of orders on ISE were 90% filled against a single contra-party, while the comparable figures for two floor-based exchanges were 35% and 37%.

While the RiskFin Analysis provided the percentage of orders on each exchange that were filled in a single execution versus multiple executions, the COATS data used for the analysis was not limited to facilitation orders.[61] Thus, the RiskFin Analysis was not dispositive with respect to ISE's contention because it contained orders unrelated to ISE's proposed order type. Concurrently with the placement of the RiskFin Analysis in the public file, the Commission issued an order extending the time to file a statement in support of or in opposition to the Original Approval Order.[62] Subsequently, the Commission received three statements relating to the RiskFin Analysis.[63]

Both CBOE and ISE focused on the RiskFin Analysis and noted that the "analysis did not confirm ISE's contention that large orders are broken-up less frequently on floor-based exchanges, though certain data did provide support for ISE's position." Although CBOE believed that the conclusion was favorable to its opposing position on ISE's QCC Order type, it clarified that it did not believe the study was necessary and that the policy question of exposure and whether it would benefit investors or not was the critical concern.[64]

Alternatively, ISE believed that the RiskFin Analysis conclusion strongly supported ISE's position that the QCC Order type is an appropriate and necessary competitive tool for the ISE.[65] In support of its belief, ISE noted that the most critical statistic in determining whether exchange members can affect a trade without being broken up is to look at how often large trades are executed in a single execution. ISE points to the RiskFin Analysis data that demonstrates that for the largest trades (2,000 or more contracts) only 12% of such trades were executed without a break-up on the ISE, while the percentages for the two floor-based exchanges were more than twice as high.[66]

Another commenter reiterated its concern that the proposed QCC Order type creates a disincentive to competitively quote by limiting price discovery opportunities and dampens transparency in the options markets.[67] In response to the RiskFin Analysis data, the commenter stated that the crossing of two orders on or within the best bid or offer of the options markets, with no interference from other participants despite exposure to the market, indicated that the cross was fairly priced as part of the off-exchange negotiation and that without exposure, there is no such comfort that the best possible price was obtained.[68]

4. Request To Vacate SR–ISE–2009–35 Original Approval Order

On July 14, 2010, concurrently with the filing of the current proposal to modify the rules for QCC Orders (*i.e.,* SR–ISE–2010–73), the Commission received a letter from ISE requesting the Commission to vacate the Original Approval Order concurrently with an approval of SR–ISE–2010–73.[69] Specifically, the Vacate Letter stated that ISE submitted its current proposal to address the most significant issues that commenters raised regarding the Original QCC Order.

D. Description of Current Proposal To Modify QCC Order Rules

As noted above, among their objections to ISE's Original QCC Order, CBOE and some commenters argued that public customers with limit orders resting on ISE's book at the execution price of a QCC Order would be harmed because the QCC Order would execute ahead of their resting orders and that, because certain customer orders would not receive priority, the proposal would create a disincentive to placing limit orders.[70] CBOE and some commenters also questioned whether the customer involved in the QCC Order would be able to receive the best price for its

[59] *See* ISE Reply, *supra* note 25, at 5.

[60] *See* Memorandum Regarding ISE Qualified Contingent Cross Proposal from Division of Risk, Strategy and Financial Innovation, dated March 1, 2010 ("RiskFin Analysis") (available at *http://www.sec.gov/rules/other/2010/sr-ise-2009–35/riskfinmemo030110.pdf*). The RiskFin Analysis reviewed COATS data from ISE, CBOE and Phlx.

[61] For example, ISE notes that the inclusion of index options trading in the data distorts the extent to which there is "break-up" of large crosses on the floor-based exchanges and believes that excluding index options from the RiskFin Analysis would significantly increase the number of floor-based exchanges' large orders that were executed without break-up. *See* ISE Statement 3, *infra* note 63, at 2–3.

[62] *See* Commission Order Extending Time to File Statements, dated March 17, 2010.

[63] *See* Letters from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Elizabeth M. Murphy, Secretary, Commission, dated April 7, 2010 ("CBOE Statement 3"); Pia K. Bennett, Associate Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated April 7, 2010 ("NYSE Statement 2"); and Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated April 7, 2010 ("ISE Statement 3").

[64] *See* CBOE Statement 3, *supra* note 63, at 1 and 4.

[65] *See* ISE Statement 3, *supra* note 63, at 2.

[66] *Id.* at 2.

[67] *See* NYSE Statement 2, *supra* note 63, at 1.

[68] *Id.* at 3.

[69] *See* Letter from Michael J. Simon, Secretary, ISE, to Elizabeth M. Murphy, Secretary, Commission, dated July 14, 2010 ("Vacate Letter").

[70] *See, e.g.,* Petition for Review, *supra* note 22, at 13, 15, 17. *See also* Bluefin Statement, *supra* note 29; Phlx Letter, *supra* note 26; Wolverine Letter, *supra* note 26; Group One Letter, *supra* note 26, at 1; and Integral Derivatives Letter, *supra* note 26.

order because, without a requirement for the order to be exposed, the submitting member's customer would not have the opportunity to receive price improvement for the options leg of the order.[71]

Though ISE believes that there is nothing novel about granting or not granting customer priority, that the Commission had approved exchange rules that do not provide customer priority, and that there is no statutory requirement that customer orders receive priority,[72] in SR–ISE–2010–73 the Exchange proposes to modify the Original QCC Order rules to require that a QCC Order be automatically cancelled if there are any Priority Customer[73] orders on the Exchange's limit order book at the same price. This modification thus prohibits QCC Orders from trading ahead of Priority Customer orders. In addition, in SR–ISE–2010–73, ISE proposes to increase the minimum size requirement for a QCC Order from 500 contracts to 1,000 contracts. ISE contends that such an increase supports the Exchange's intention to permit the crossing of only large-sized institutional stock-option orders.[74]

Thus, as modified, an ISE member effecting a trade pursuant to the NMS QCT Exemption could cross the options leg of the trade on ISE as a QCC Order immediately upon entry, without exposure, only if there are no Priority Customer orders on the Exchange's limit order book at the same price and if the order: (i) Is for at least 1,000 contracts; (ii) meets the six requirements of the NMS QCT Exemption;[75] and (iii) is executed at a price at or between the NBBO ("Modified QCC Order").[76] In the Notice, ISE stated that the modifications to the Original QCC Order (*i.e.,* to prevent the execution of a QCC if there is a Priority Customer on its book and to increase the minimum size of a QCC Order) remove the appearance that such orders are trading ahead of Priority Customer orders or that the QCC Order could be used to disadvantage retail customers.[77]

E. Commenters to ISE's Modified QCC Order Proposal

The Commission received eight comment letters opposing ISE's Modified QCC Order proposal and a response letter from ISE.[78] While some commenters noted that ISE had addressed their prior objections relating to customer priority,[79] commenters objected to ISE's modified proposal because it remained unchanged from the original proposal with respect to exposure, in that QCC Orders would still be crossed without exposure.[80] Commenters noted that exposure is especially critical in the options market, which is quote-driven and relies on market makers to ensure that two-sided quotations are available for hundreds of thousands of different options series.[81] Commenters argued that exposure, in addition to allowing for the possibility of price improvement, provides market makers an opportunity to participate in trades, which in turn provides them incentives to quote aggressively, thus benefiting the market as a whole.[82]

Relatedly, several commenters warned against removing incentives for liquidity providers in light of the market events of May 6, 2010.[83] One commenter noted that any tightening of market maker obligations could only succeed if market maker benefits were correspondingly aligned, and argued that ISE's proposal would withdraw significant options order flow and, thus, the opportunity for market makers to interact with that order flow via exposure.[84]

In addition, CBOE stated that order exposure and the opportunity for market participant interaction was integrally related to what constitutes an exchange and stressed that the Commission should not abandon such long-held standards to permit "print" mechanisms on options exchanges, which it believed the ISE proposal to be.[85] CBOE and NYSE also noted that the Commission has generally not permitted 100% participation guarantees, as the QCC Order would provide for.[86]

CBOE also noted that the component legs of stock-option orders are exposed on options exchanges as a package (*e.g.,* through complex order mechanisms) with all terms of the complete order being transparent to the marketplace.[87] This commenter noted that such stock-option orders, while still requiring exposure, are granted intermarket trade-through relief. In contrast, this commenter saw no reason why QCC Orders should receive any special treatment (*i.e.,* not be required to be exposed) and noted that they are not represented as a package and thus do not provide the same transparency as stock-option orders, with only upstairs parties to these trades aware of the complete terms of the total transaction.[88] In response, ISE reiterated its belief that 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 are executed with little, if any. interruption.[89] ISE stated that commenters opposed to its proposal were arguing about the theoretical benefits of exposure and ignoring the realities of what is occurring in the markets.[90] Further, ISE stated that, currently, members arrange large stock-option trades upstairs and then bring them to an exchange for execution. Floor exchanges, ISE argued, accommodate these trades by providing a market structure where there is little

[71] *See, e.g.,* CBOE Statement 1, *supra* note 29, at 7–8 and Petition for Review, *supra* note 22, at 13. *See also* Bluefin Statement, *supra* note 29; Group One Letter, *supra* note 26, at 1–2; and Integral Derivatives Letter, *supra* note 26.

[72] *See* ISE Statement 1, *supra* note 28, at 4. *See also* Capstone Statement, *supra* note 28, at 2.

[73] Under ISE Rule 100(37A), a priority customer is a person or entity that (i) is not a broker or dealer in securities, and (ii) does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Pursuant to ISE Rule 713, priority customer orders are executed before other trading interest at the same price.

[74] *See* Vacate Letter, *supra* note 69, at 1.

[75] *See supra* notes 9 and 13 and accompanying text.

[76] If there are Priority Customer orders on ISE's limit order book at the same price, the QCC Order would be automatically canceled. *See* proposed ISE Rule 721(b)(1).

[77] *See* Notice, *supra* note 3.

[78] *See supra* notes 4 and 5.

[79] *See* CBOE Letter 1, *supra* note 4, at 1, NYSE Letter 2, *supra* note 4, at 7, and Susquehanna Letter 2, *supra* note 4, at 1. *See also supra* notes 44–54 and accompanying text.

[80] *See* CBOE Letter 1, *supra* note 4, at 1; Phlx Letter 2, *supra* note 4, at 1; LiquidPoint Letter 2, *supra* note 4, at 1–2; Group One Letter 2, *supra* note 4, at 1; NYSE Letter 2, *supra* note 4, at 1–2, 7–8; and Susquehanna Letter 2, *supra* note 4, at 1.

[81] *See* CBOE Letter 1, *supra* note 4, at 1–2; Phlx Letter 2, *supra* note 4, at 1; LiquidPoint Letter 2, *supra* note 4, at 1, 2; Group One Letter 2, *supra* note 4, at 2; NYSE Letter 2, *supra* note 4, at 3, 7–8; NYSE Letter 3, *supra* note 4, at 2; and Susquehanna Letter 2, *supra* note 4, at 3.

[82] *See* CBOE Letter 1, *supra* note 4, at 2–3 and Phlx Letter 2, *supra* note 4, at 1. *See also* Cutler Letter, *supra* note 4 (stating that without exposure, there is no incentive for market makers to display liquidity, provide liquidity or offer price improvement) and LiquidPoint Letter 2, *supra* note 4, at 2 (stating that if market makers are not able to participate in *all* price discovery opportunities, they would be left to participate in only price discovery opportunities that are less-desirable and that the result of this negative selection would be "increased risk, a higher probability of unprofitable trades and a reticence to post their best markets. *See also* Group One Letter 2, *supra* note 4, at 2; NYSE Letter 2, *supra* note 4, at 2, 3; and Susquehanna Letter 2, *supra* note 4, at 3.

[83] *See* CBOE Letter 1, *supra* note 4, at 1, 3–4; Group One Letter 2, *supra* note 4, at 2; and NYSE Letter 2, *supra* note 4, at 2.

[84] *See* CBOE Letter 1, *supra* note 4, at 3.

[85] *See* CBOE Letter 1, *supra* note 4, at 3, 5.

[86] *See* NYSE Letter 2, *supra* note 4, at 3; NYSE Letter 3, *supra* note 4, at 1–2; and CBOE Letter 1, *supra* note 4, at 2.

[87] *See* CBOE Letter 1, *supra* note 4, at 4–5. *See also* NYSE Letter 2, *supra* note 4, at 4.

[88] *See* CBOE Letter 1, *supra* note 4, at 4–5. *See also* Cutler Letter, *supra* note 4; and NYSE Letter 2, *supra* note 4, at 4.

[89] *See* ISE Statement 1, *supra* note 28, at 3.

[90] *See* ISE Response, *supra* note 5, at 2.

or no chance that members will break up the pre-arranged trade.[91] Another commenter believed that splitting a stock-option order into separate executions for the individual stock and options legs, rather than representing the stock-option order as a package, was generally not in the best interest of the customer from a best execution point of view.[92]

Another commenter reiterated its belief that the benefits of price discovery and transparency afforded by exposure were especially crucial for broker facilitated crosses such as QCC Orders because of the inherent conflict of interest for such orders since a broker is "betting against the customer" in such trades.[93] Commenters also contended that ISE's claim that it needed the QCC Order to compete with trading on floor-based exchanges is erroneous and disingenuous, and that it ignored the broader ramification of QCC Orders that, whereas trading floors require exposure of orders before any executions can occur, the QCC Order would ensure that exposure was eliminated altogether.[94]

With respect to the increase in contract size for QCC Orders from 500 contracts (as originally proposed in SR–ISE–2009–35) to 1,000 contracts, NYSE questioned whether the change was meaningful in limiting the scope of the proposed QCC Order type, as it believed that market participants could game the rule to meet this requirement,[95] while another commenter believed that the 1,000 contract requirement was a relatively low threshold that would permit large broker-dealers to shut out other market participants on relatively small trades.[96]

In its response letter, ISE reiterated its argument that its QCC Order proposals were simply a way for ISE to compete against floor-based options exchanges for the execution of large stock-option orders.[97] ISE countered commenters' arguments regarding the lack of exposure of QCC Orders by stating that the required exposure of orders on floor-based exchanges was nominal and theoretical, and ignores the realities of what is occurring on those markets.[98] One commenter agreed with ISE's assertion that floor-based options exchanges enjoy an unfair competitive advantage over all-electronic options exchanges for executing clean blocks, noting that, in its own experience, "institutional brokers are much more apt to use a trading floor when the primary intention is to execute as clean a cross as possible."[99] ISE stated its belief that floor-based options markets accommodate such trades by "providing a market structure in which there is little or no chance that members will break up the pre-arranged trade" by structuring their markets to provide such trades with the least amount of "friction."[100] ISE contended that, if floor-based exchanges were serious about exposure, they would expose such orders to their entire marketplace, rather than limiting exposure to "those few (if any) members physically present in the floor-based trading crowd."[101] One commenter echoed ISE's contention and suggested that a common rule for all block crosses on all options exchanges should be adopted to require all pre-negotiated option block crosses, including floor crosses, to be entered into an electronic crossing mechanism. This commenter believed that such a requirement would ensure that market makers could compete for such orders and thus provide the orders a greater chance at price improvement, as well as act as a check to ensure that the brokers facilitating these orders priced them competitively.[102]

ISE also countered commenters' arguments that the QCC Order proposal, because it does not provide for exposure, would not allow for price improvement by reiterating its prior explanation that those parties involved in a stock-option order negotiate such transactions on a "net price" basis, reflecting the total price of both the stock and options legs of the trade. Thus, ISE argued, the actual execution price of each individual component is not as material to the parties involved as is the net price of the entire transaction, which ISE believes means that price improvement of the individual legs of the trade is not a critical issue in the execution of a QCC Order.[103]

In addition, ISE argued that its QCC Order proposal has no relevance to the market events of May 6, 2010, despite commenters' attempts to link the two. ISE again noted that large stock-options trades are currently arranged upstairs and then shopped among exchanges to achieve a clean cross.[104] ISE argued that, accordingly, large stock-option trades today "rely on the liquidity that firms can provide in arranging these trades and do not now include exchange-provided liquidity."[105] ISE believed that the QCC Order type would simply provide a competitive electronic vehicle for such trades and will have no effect on available liquidity.[106]

In response to NYSE's contention that the QCC Order's contract size requirement could be gamed, ISE noted that any member creating "fake customer orders" would be misrepresenting its order in violation of ISE's rules and expressed confidence that its surveillance program would be able to catch any such attempt.[107] In addition, ISE clarified the calculation of the 1,000 contract minimum size for a QCC Order noting that, in order to meet this requirement, an order must be for at least 1,000 contracts and could not be, for example, two 500 contract orders or two 500 contract legs.[108]

III. Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.[109] Specifically, the Commission finds that the proposal is consistent with Sections 6(b)(5)[110] and 6(b)(8),[111] which require, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest and that the rules of an exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. In addition, the Commission finds that the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act,[112] in which Congress found that it is in the public

[91] *Id.*

[92] *See* Susquehanna Letter 2, *supra* note 4, at 4–5.

[93] *See* Group One Letter 2, *supra* note 4, at 1–2. *See also supra* note 55 and accompanying text.

[94] *See* CBOE Letter 1, *supra* note 4, at 4–5. *See also* NYSE Letter 2, *supra* note 4, at 3–4 and NYSE Letter 3, *supra* note 4, at 2.

[95] *See* NYSE Letter 2, *supra* note 4, at 5–7 and NYSE Letter 3, *supra* note 4, at 3.

[96] *See* Cutler Letter, *supra* note 4.

[97] *See* ISE Response, *supra* note 5, at 1–2.

[98] *Id.* at 2.

[99] *See* Susquehanna Letter 2, *supra* note 4, at 2.

[100] *Id.*

[101] *Id.*

[102] *See* Susquehanna Letter 2, *supra* note 4, at 2.

[103] *See* ISE Response, *supra* note 5, at 3–4.

[104] *See* ISE Response, *supra* note 5, at 4.

[105] *Id.*

[106] *Id.*

[107] *Id.* at 5–6.

[108] *Id.* at 6.

[109] 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[110] 15 U.S.C. 78f(b)(5).

[111] 15 U.S.C. 78f(b)(8).

[112] 15 U.S.C. 78k–1(a)(1)(C).

interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure, among other things, the economically efficient execution of securities transactions.

A. Consistency With the NMS QCT Exemption

In approving the Original QCT Exemption, the Commission recognized that contingent trades can be "useful trading tools for investors and other market participants, particularly those who trade the securities of issuers involved in mergers, different classes of shares of the same issuer, convertible securities, and *equity derivatives such as options* [italics added]." [113] The Commission stated that "[t]hose who engage in contingent trades can benefit the market as a whole by studying the relationships between the prices of such securities and executing contingent trades when they believe such relationships are out of line with what they believe to be fair value." [114] As such, the Commission stated that transactions that meet the specified requirements of the NMS QCT Exemption could be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process.[115]

The parties to a contingent trade are focused on the spread or ratio between the transaction prices for each of the component instruments (*i.e.,* the net price of the entire contingent trade), rather than on the absolute price of any single component.[116] Pursuant to the requirements of the NMS QCT Exemption, the spread or ratio between the relevant instruments must be determined at the time the order is placed, and this spread or ratio stands regardless of the market prices of the individual orders at their time of execution. As the Commission noted in the Original QCT Exemption, "the difficulty of maintaining a hedge, and the risk of falling out of hedge, could dissuade participants from engaging in contingent trades, or at least raise the cost of such trades." [117] Thus, the Commission found that, if each stock leg of a qualified contingent trade were required to meet the trade-through provisions of Rule 611 of Regulation NMS, such trades could become too risky and costly to be employed successfully and noted that the elimination or reduction of this trading strategy potentially could remove liquidity from the market.[118]

The Commission believes that ISE's proposal, which would permit a clean cross of the options leg of a subset of qualified contingent trades (*i.e.,* a stock-option qualified contingent trade that meets the requirements of the NMS QCT Exemption), is appropriate and consistent with the Act in that it would facilitate the execution of qualified contingent trades, for which the Commission found in the Original QCT Exemption to be of benefit to the market as a whole, contributing to the efficient functioning of the securities markets and the price discovery process.[119] The QCC Order would provide assurance to parties to stock-option qualified contingent trades that their hedge would be maintained by allowing the options component to be executed as a clean cross.

B. Exposure and Qualified Contingent Trades

Commenters believed that ISE's modifications to the Original QCC Order did not adequately address their main objection regarding the QCC Order, particularly in that it would continue to permit option crosses to occur without prior exposure to the marketplace. Commenters generally reiterated their prior comments that exposing options orders promotes price competition, increases order interaction, and leads to better quality executions for investors by providing opportunities for price improvement.[120] These commenters continued to argue that, without exposure, the Modified QCC Order would cause significant harm to the options market because it would eliminate valuable incentive for dedicated liquidity provider participation.[121]

In response to commenters' concerns that the Modified QCC Order would have a detrimental effect on the options markets because of the lack of any exposure requirement, ISE stated that exchange members arrange large stock-option trades upstairs and then bring them to an exchange for execution, and that exchange floors accommodate the trades by providing a market structure in which there is little or no chance that members will break up the pre-arranged trade.[122] ISE believed that, rather than harming the options markets, the QCC proposal would permit fair competition to occur between floor-based and all-electronic options exchanges by providing an all-electronic execution alternative to floor-based executions.[123]

The Commission recognizes that significant liquidity on options exchanges is derived from quotations submitted by members of an exchange that are registered as market makers.[124] Pursuant to the options exchanges' rules, market makers generally are required to maintain continuous two-sided quotations in their registered options for a specified percentage of the time, or in a specified number of series or classes. One of the perceived benefits for market makers with such obligations is the opportunity to participate in transactions through the exposure requirement. As noted above, some commenters argue that the lack of exposure for QCC Orders would act as a disincentive for market maker participation.[125]

While the Commission believes that order exposure is generally beneficial to options markets in that it provides an incentive to options market makers to provide liquidity and therefore plays an important role in ensuring competition and price discovery in the options markets, it also has recognized that contingent trades can be "useful trading tools for investors and other market participants, particularly those who trade the securities of issuers involved in mergers, different classes of shares of the same issuer, convertible securities, and *equity derivatives such as options* [italics added]".[126] and that "[t]hose who engage in contingent trades can benefit the market as a whole by studying the relationships between the prices of such securities and executing contingent trades when they believe such relationships are out of line with what they believe to be fair value." [127] As such, the Commission stated that transactions that meet the specified requirements of the NMS QCT Exemption could be of benefit to the market as a whole, contributing to the efficient functioning of the securities

[113] *See* Original QCT Exemption, *supra* note 9, at 52830.

[114] *Id.* at 52831.

[115] *See* CBOE QCT Exemption, *supra* note 13.

[116] *See* Original QCT Exemption, *supra* note 9, at 52829 (explaining SIA's position on the need for the Original QCT Exemption).

[117] *Id.* at 52831.

[118] *Id.*

[119] *Id.*

[120] *See supra* notes 70 and 85–94 and accompanying text.

[121] *See supra* notes 81–84 and accompanying text.

[122] *See supra* notes 97–100 and accompanying text.

[123] *See* ISE Response, *supra* note 5, at 3.

[124] *See, e.g.,* Susquehanna Letter 2, *supra* note 4, at 3 (noting that, in the options market, market makers provide over 90% of the liquidity).

[125] *See supra* notes 81–82 and accompanying text.

[126] *See* Original QCT Exemption, *supra* note 9, at 52830–52831.

[127] *Id.*

markets and the price discovery process.[128]

Thus, in light of the benefits provided by both the requirement for exposure as well as by qualified contingent trades such as QCC Orders, the Commission must weigh the relative merits of both for the options markets.[129] The Commission believes that the proposal, in requiring a QCC Order to be: (1) Part of a qualified contingent trade under Regulation NMS; (2) for at least 1,000 contracts; (3) executed at a price at or between the national best bid or offer; and (4) cancelled if there is a Priority Customer Order on ISE's limit order book, strikes an appropriate balance for the options market in that it is narrowly drawn [130] and establishes a limited exception to the general principle of exposure and retains the general principle of customer priority in the options markets. Furthermore, not only must a QCC Order be part of a qualified contingent trade by satisfying each of the six underlying requirements of the NMS QCT Exemption, the requirement that a QCC Order be for a minimum size of 1,000 contracts provides another limit to its use by ensuring only transactions of significant size may avail themselves of this order type.[131]

As noted above, some commenters argue that the concerns regarding the impact of the QCC Order on the incentives for liquidity providers are heightened by the events of May 6, 2010.[132] Specifically, commenters argued that in light of the events of May 6, 2010, the Commission should not improve measures that would create disincentives for market makers to provide liquidity to the markets.[133] The Commission recognizes the important role liquidity providers play, particularly in the options markets, which tend to be more quote driven than the cash equities markets. In addition, the Commission is cognizant of the concerns raised by some commenters with regard to the events of May 6, 2010. However, as discussed above, the Commission has weighed the relative merits of the QCC Order and of the exposure of such orders and believes that ISE's proposal is consistent with the Act.

C. Customer Protection

In response to concerns that the Original QCC Order did not provide adequate customer protection because the QCC Order would have priority over resting customer orders on ISE's books,[134] ISE proposes to modify the QCC Order to provide for automatic cancellation of a QCC Order if there is a Priority Customer order on the Exchange's limit order book at the same price. The Commission believes that this modification to yield to a Priority Customer order on the book would ensure that QCC Orders do not trade ahead of Priority Customer orders at the same price, and thus should alleviate commenters' concerns regarding the Original QCC Order that customers would not receive executions of their resting orders, which could also create a disincentive to placing limit orders.

Some commenters objected to the Modified QCC Order because they believed that a customer order submitted as a QCC Order risks receiving a fill at an inferior price to the price it could have received if it has been exposed to the market.[135] Another commenter was concerned that, while the option trade would be within the NBBO, the stock trade may be priced outside of the market and that "[t]he effect is a valuation for the stock/option package * * * unrestricted by competition * * *."[136] In response to commenters concerns regarding price improvement, ISE argued that the actual execution price of each component is not as material to the parties as is the net price of the transaction and accordingly, price improvement of the individual legs of the trade is not a critical issue in executing the QCC Order.[137]

As discussed above, QCC Orders must be for 1,000 or more contracts, in addition to meeting all of the requirements of the NMS QCT Exemption. The Commission believes that those customers participating in QCC Orders will likely be sophisticated investors who should understand that, without a requirement of exposure for QCC Orders, their order would not be given an opportunity for price improvement on the Exchange. These customers should be able to assess whether the net prices they are receiving for their QCC Order are competitive, and who will have the ability to choose among broker-dealers if they believe the net price one broker-dealer provides is not competitive. Further, broker-dealers are subject to a duty of best execution for their customers' orders, and that duty does not change for QCC Orders.

IV. Conclusion

In sum, the Commission believes that ISE's Modified QCC Order is consistent with the NMS QCT Exemption, which found that qualified contingent trades are of benefit to the market as a whole and a contribution to the efficient functioning of the securities markets and the price discovery process.[138] In addition, the Exchange's Modified QCC Order is narrowly drawn to provide a limited exception to the general principle of exposure, and retains the general principle of customer priority. Accordingly, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, with Section 6(b) of the Act.[139] Specifically, the Commission finds that the proposal is consistent with Sections 6(b)(5) [140] and 6(b)(8) of the Act.[141] Further, the Commission finds that the proposed rule change is consistent with Section 11A(a)(1)(C) of the Act.[142]

It is therefore ordered, the proposed rule change (SR–ISE–2010–73) is approved pursuant to Section 19(b)(2) of the Act.[143]

By the Commission.

Elizabeth M. Murphy,

Secretary.

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[128] *See* CBOE QCT Exemption, *supra* note 13, at 19273.

[129] The Commission notes that it has previously permitted the crossing of two public customer orders, for which no exposure is required on ISE and CBOE. *See* CBOE Rule 6.74A.09 and ISE Rules 715(i) and 721.

[130] The Commission notes that, in its request to remove the block-size requirement of the Original QCT Exemption, CBOE stated that the NMS QCT Exemption's other requirements would ensure that the exemption was narrowly drawn and limited to a small number of transactions. *See* Letter, dated November 28, 2007, from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Nancy M. Morris, Secretary, Commission, at 1, 4.

[131] The Commission notes that the requirement that clean crosses be of a certain minimum size is not unique to the QCC Order. *See, e.g.,* NSX Rule 11.12(d), which requires, among other things, that a Clean Cross be for at least 5,000 shares and have an aggregate value of at least $100,000.

[132] *See supra* notes 83–84 and accompanying text.

[133] *Id.*

[134] *See* Petition for Review, *supra* note 22, at 15, 17. *See also* Bluefin Statement, *supra* note 29; Phlx Letter, *supra* note 26; Wolverine Letter, *supra* note 26; Group One Letter, *supra* note 26, at 1; and Integral Derivatives Letter, *supra* note 26.

[135] *See* Group One Letter 2, *supra* note 4, at 1; and CBOE Letter 1, *supra* note 4, at 2.

[136] *See* LiquidPoint Letter 2, *supra* note 4, at 2.

[137] *See supra* note 103 and accompanying text.

[138] *See supra* note 13.

[139] 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[140] 15 U.S.C. 78f(b)(5).

[141] 15 U.S.C. 78f(b)(8).

[142] 15 U.S.C. 78k–1(a)(1)(C).

[143] 15 U.S.C. 78s(b)(2).