

December 19, 2003

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: File No. SR-CBOE-2003-33; Release No. 34-48815

Dear Mr. Katz:

The International Securities Exchange, Inc. ("ISE") appreciates the opportunity to comment on the proposal ("Proposal") by the Chicago Board Options Exchange, Inc. ("CBOE") to increase transaction charges on orders its members execute on behalf of market makers who are not CBOE members. We believe that the CBOE's filing does not comply with the procedural filing requirements of Rule 19b-4 under the Securities Exchange Act of 1934 ("Exchange Act"). Furthermore, we believe that, based on the sparse discussion in the filing, the Proposal does not meet the substantive requirements of the Exchange Act. Thus, we urge the Commission either to reject the filing as not in compliance with Exchange Act filing requirements, or, alternatively, to institute proceedings to disapprove the Proposal.

The Exchange Act requires that the rules of an exchange provide "for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities."¹ Furthermore, an exchange's rules cannot be designed to permit "unfair discrimination between customers, . . . brokers, [or] dealers" ² The CBOE's filing fails to explain how the Proposal is consistent with these requirements.

In discussing the statutory basis for the Proposal, the filing simply contains boilerplate language that the Proposal will provide for an equitable allocation of fees, without providing any reasoning for that conclusion. In describing why it is proposing the fee increase, the CBOE only states that it currently charges uniform fees for all non-customer executions, and that "[CBOE] members have complained that such equivalence of fees is unfair to Exchange members, who pay a variety of additional fees through their membership in the [CBOE] to help offset the [CBOE's] expenses."

We do not believe that member "complaints" about fairness satisfy the statutory requirements for justifying discriminatory exchange fees. Nor do the substance of those complaints provide a justification for discriminating against non-member market makers.

¹ Exchange Act Section 6(b)(4).

² Exchange Act Section 6(b)(5).

If such complaints are justified (a hypothetical situation given the CBOE's failure to provide any justification), the members' concerns should be with the order flow of *all broker-dealers* that are not CBOE members, not just market makers. We have reviewed the CBOE's fee schedule as posted on its Internet web site³, and there do not appear to be any fees that non-member broker-dealers generally pay, but do not apply to non-member market makers. Thus, any concerns about the failure of one category of order flow providers to pay "a variety of additional fees" should apply to the entire class of non-member broker-dealers. The CBOE does not explain its justification for discriminating against only one subset of this group: non-member market makers.

The Proposal also is anticompetitive: it will act as a disincentive for non-member market makers to send order flow to the CBOE in an attempt to further the price-discovery process and to adjust market-making positions. We recognize that the CBOE does not propose to increase its fees for trades executed through the intermarket linkage ("Linkage"). However, the Linkage does not, in and of itself, provide competing market makers with full access to other exchanges. Except for when they hold unexecuted customer orders, market makers can use Linkage only to send "Principal Orders." In this regard, the Linkage Plan specifically states that market makers "should send Principal Orders through the Linkage on a limited basis and not as a primary aspect of their business."⁴ The Plan further imposes a strict mathematical limit on the sending of Principal Orders.⁵ Thus, the availability of Linkage as a limited alternative by which non-member market makers can send orders to the CBOE does not provide a basis to permit the CBOE's proposed discriminatory fee for access outside of Linkage.

Finally, approval of the Proposal likely will have cascading negative effects. If the Commission were to conclude that member complaints about fairness of fees is a proper basis for discriminatory treatment of competing market makers, we believe that our market makers likely will complain about the fees we charge for the order flow of their competitors. It is also reasonable to assume that other exchanges will receive similar complaints. Since raising fees that impact your competitors is a relatively easy source of new revenues, it is likely that we and the other exchanges will file proposals similar to that of the CBOE. This will only increase the economic disincentives for market makers to send orders to other exchanges, thus decreasing market efficiency and harming price discovery. Ultimately the result will be harm to customers seeking to receive the best price for their orders.

The CBOE's filing does not provide an adequate justification for this proposed discrimination against non-member market makers, and the scant justification provided does not support a proposal that is limited to competing market makers. Thus, we urge the Commission either to reject the CBOE's filing as not in compliance with Rule 19b-4 under the Exchange Act or to commence proceedings to disapprove the Proposal.

³ [Http://www.cboe.com/AboutCBOE/FeeSchedule.pdf](http://www.cboe.com/AboutCBOE/FeeSchedule.pdf); CBOE fee schedule dated November, 2003.

⁴ Plan for the Purpose of Creating and Operating an Intermarket Option Linkage, at section 8(b)(iii).

⁵ *Id.*

We thank the Commission for the opportunity to comment on the Proposal, and we are available to discuss this issue with either the Commission or its staff if you would find that useful.

Sincerely,

Michael J. Simon
Senior Vice President and Secretary

cc: Annette Nazareth
Robert Colby
Elizabeth King