

**VIA EMAIL AND FEDERAL EXPRESS**

October 22, 2002

Mr. Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

**RE: File No. SR-OC-2002-01; OneChicago, LLC Customer Margin Rules**

Dear Mr. Katz:

The International Securities Exchange, Inc. (“ISE”) appreciates this opportunity to comment on the captioned proposal of OneChicago, LLC (“OneChicago”) relating to customer margin requirements for security futures, particularly proposed Rule 515(n) entitled Exclusion for Market Makers (the “Market Maker Exclusion”).<sup>1</sup> For the reasons set forth below, we strongly urge the Securities and Exchange Commission (“Commission”) not to approve the proposal. We specifically object to proposed paragraphs (n)(C)(x) and (y) of Rule 515, which specify the conditions under which a market maker “hold[s] itself out as being willing to buy and sell security futures for its own account on a regular or continuous basis.”

The Market Maker Exclusion grants beneficial market maker margin treatment (and, thus, an exemption from the customer margin requirements under the Securities Exchange Act of 1934 (the “Exchange Act”)) to a OneChicago market maker that: (a) meets certain registration requirements; (b) meets certain record-keeping requirements; and (c) *hold[s] itself out as willing to buy and sell security futures for its own account on a regular or continuous basis.*

As proposed by OneChicago, a market maker would hold itself out as willing to buy and sell security futures for its own account on a regular or continuous basis if either: (x) at least seventy-five percent (75%) of its gross revenue on an annual basis is derived from business activities or occupations from trading listed financial derivatives and the instruments underlying those derivatives, including security futures, stock index futures and options, stock and index options, stocks, foreign currency futures and options, foreign currencies, interest rate futures and options, fixed income instruments and commodity futures and options (the “Revenue Test”); or (y) except for unusual circumstances, at least fifty percent (50%) of its trading activity in contracts on

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<sup>1</sup> See Securities Exchange Act Release No. 46555 (September 26, 2002), 67 FR 61707 (October 1, 2002).

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OneChicago in any calendar quarter (measured in terms of contract volume) is in the contracts to which it is assigned under a market making program adopted by OneChicago pursuant to Rule 514 (the "Volume Test").

We fail to see how either test is relevant to the requirement that a market maker hold itself out as willing to buy and sell security futures products on a regular or continuous basis. In fact, OneChicago's Revenue Test and Volume Test appear to us to be clearly inconsistent with the requirements of Section 7(c)(2)(B) of the Exchange Act, which provides, in relevant part, that:

The margin requirements for a security futures product be consistent with the margin requirements for comparable option contracts traded on any exchange registered pursuant to section 6(a)

Since the Exchange Act prohibits OneChicago from lowering the absolute dollar amount of margin required for security futures below that for which is required for comparable option contracts, OneChicago is attempting to lower the margin by creating tests that would, in effect, qualify virtually every registered broker-dealer that conducts a proprietary trading business for beneficial market maker margin treatment when it trades at OneChicago. If approved by the Commission, the Market Maker Exclusion would improperly confer market maker margin treatment on a substantial number of firms that should be subject to regular customer margin requirements.

Under the Revenue Test, we question how, without an accompanying continuous quoting obligation, a market maker at OneChicago could hold itself out as willing to buy and sell security futures for its own account on a regular or continuous basis at OneChicago if the market maker's primary business (as measured by annual gross revenue in excess of 75%) consists of trading foreign currency futures at the Chicago Mercantile Exchange. Similarly, under the Volume Test, we question how, without an accompanying continuous quoting obligation, a market maker at OneChicago could hold itself out as willing to buy and sell security futures for its own account on a regular or continuous basis at OneChicago if the market maker submits and executes a single order per calendar quarter to trade five contracts, three of which are in a name assigned to it under a yet-to-be disclosed market making program.

Clearly, the answer to both questions is that satisfying either test does not constitute holding yourself out as willing to buy and sell security futures for your own account on a regular or continuous basis. Neither test requires a market maker to maintain a two-sided quote with any size for any duration of the trading day. Actually,

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neither test even requires a market maker to participate in the OneChicago market at all. But, if a market maker did decide to send an order to OneChicago, it would be guaranteed beneficial market maker margin treatment for its resulting positions.

Each of the five listed options exchanges imposes varying degrees of affirmative quoting obligations on its market makers. At ISE, our Rule 804 requires our Primary Market Makers to, among other things, continuously provide two-sided quotes in every series of every options class in their assigned bin. Competitive Market Makers are required to, among other things, continuously provide two-sided quotes in every series of at least 60% of the options classes in their assigned bin. In addition, ISE Rule 804 requires all market makers to enter their quotations with a minimum size of ten contracts. There are comparable requirements on all of the five listed options exchanges.

While we are not suggesting that the Commission require OneChicago to adopt rules identical to what is required by the five listed options exchanges, we are urging the Commission to require OneChicago to adopt requirements that place meaningful, affirmative quoting obligations on OneChicago market makers in order to maintain the Congressionally mandated regulatory parity between security futures and listed options. Additionally, we urge the Commission to carefully consider the extent to which approval of OneChicago's standards for defining "hold[s] itself out as being willing to buy and sell security futures for its own account on a regular or continuous basis" would serve as precedent for each of the five listed options exchanges to modify and/or eliminate their respective continuous quoting obligations for their market makers in order to compete with the OneChicago market maker model.

Accordingly, for the reasons set forth above, ISE strongly urges the Commission not to approve the proposal. We thank the Commission for this opportunity to comment on the proposed rule change. If you have any questions, please do not hesitate to call me.

Sincerely,

Michael J. Simon  
Senior Vice President and Secretary

cc: Annette L. Nazareth, Esq.  
Robert L.D. Colby, Esq.  
Elizabeth K. King, Esq.  
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