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Re: File Number 4-887, Options Market Structure Roundtable

Dear Ms. Countryman,

I appreciate the opportunity to submit this comment letter in advance of the SEC's options market structure roundtable. In recent years, the U.S. listed options market has experienced substantial growth in trading volume, investor participation, and product innovation. In light of these developments, the roundtable is both timely and important. I respectfully suggest seven areas for consideration:

1. Require execution quality disclosure for listed options.
Execution quality disclosure promotes market discipline, enhances competition among broker-dealers and exchanges, and benefits investors. While such disclosure has long been required and periodically updated for the U.S. equity market (i.e., Rule 605 reports), no comparable requirement exists for listed options. This is a clear regulatory gap. While the complexity of options markets, with numerous strike prices and expiration dates, necessitates careful aggregation, this technical challenge is well suited to the notice-and-comment rulemaking process.

2. Prepare the options market for 23/5 trading in U.S. equities on exchanges.
Option prices are highly sensitive to movements in their underlying securities. Economic and geopolitical news during Asian and European trading hours can lead to significant price adjustments of options at the U.S. open. Currently, the absence of consolidated tape data between 8:00 p.m. and 4:00 a.m. ET obscures overnight mark-to-market changes in options valuations. As overnight equity trading develops, alongside quote and trade dissemination via the SIP, the impact of overnight stock price movements on options valuation, margining, and risk management will become more immediate and visible. The SEC is best positioned to coordinate industry readiness for this transition.

3. Prepare for the arrival (or return) of listed binary options resembling event contracts.
Consider a contract that pays $1 if a company's stock closes above a specified price on a given date, or one that pays $1 if a firm's earnings exceed a stated threshold. Economically, these are binary options. While conceptually simple, such instruments present challenges for hedging and risk management due to discontinuous payoffs around the strike. Given surging retail participation in event contracts, binary options tied to securities or corporate fundamentals may also proliferate. Binary options on single securities or narrow indices fall within the SEC's jurisdiction. SEC coordination is important for industry preparedness, just as SEC oversight of this market is important for investor protection.

4. Reevaluate options tick sizes.
Listed options typically trade in minimum increments of $0.01, $0.05, or $0.10. Because options embed leverage, their dollar prices are typically much lower than those of the underlying equities. Wider tick sizes, coupled with lower price levels, generally lead to higher effective trading costs in options compared to equities. While excessively small price increments have drawbacks, it is reasonable to consider narrowing the wide tick sizes for $0.05 and $0.10 options classes to reduce transaction costs. For example, the SEC could consider an alignment between the tick sizes of listed options and the underlying NMS stocks.

5. Reduce contract sizes for options on high-priced equities.
Currently, each options contract gives the holder an economic exposure equivalent to 100 shares. Smaller contract sizes for options on high-priced securities could help narrow quoted spreads and reduce transaction costs, particularly for retail investors. Additionally, harmonizing the contract size of options and the round lot size of underlying NMS stocks can further improve price efficiency across these closely related markets.

6. Enhance competition for retail options order flow.
Because listed options must be executed on exchange, intermediaries (often referred to as "consolidators") aggregate and route retail orders to exchanges. While exchanges often provide allocation preferences or guarantees to such intermediaries, these arrangements can dampen competition once retail orders reach the exchange. Strengthening competitive dynamics for retail order execution would lead to improved execution quality and lower costs for investors.

7. Address redundancy in options regulatory fees (ORFs).
Options regulatory fees are assessed by exchanges on their members, but the current structure results in significant duplication. A broker-dealer that is a member of multiple exchanges may pay ORFs to each exchange for a single trade, including to exchanges not involved in the trade. This redundancy imposes unnecessary costs. A more efficient approach would assess the transaction-based regulatory fee once, to be paid only to the executing exchange. This alternative approach could strengthen options exchanges' incentives for delivering better execution quality and help mitigate market fragmentation. Because no single exchange is likely to change its current practice unilaterally, SEC action would be necessary to facilitate a shift in equilibrium.

Sincerely,
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MIT and NBER