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July 27, 2017

Sent by Electronic Mail to Rule-Comments@sec.gov

Mr. Brent J. Fields
Secretary
U.S. Securities & Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

RE: Exchange Act Rel. No. 81067. Whether to Approve or Disapprove Proposed Rule Changes to Establish Fees for Industry Members to Fund the Consolidated Audit Trail. File Nos. SR-BatsBZX-2017-11; SR-BatsBZX-2017-38; SR-BatsEDGA-2017-13; SR-Bats-EDGX-2017-22; SR-BOX-2017-16; SR-BX-2017-023; SR-C2-2017-017; SR-CBOE-2017-08; SR-CHX-2017-08; SR-FINRA-2017-011; SR-GEMX-2017-17; SR-IEX-2017-16; SR-MIAX-2017-18; SR-MRX-2017-04; SR-NASDAQ-2017-046; SR-NYSE-2017-22; SR-NYSEMKT-2017-26; SR-PEARL-2017-20; SR-PHLX-2017-37

Dear Mr. Fields:

Wolverine Trading, LLC ("Wolverine"). Susquehanna International Group, LLP ("Susquehanna"), IMC Financial Markets ("IMC"), Optiver US, LLC, and (collectively referred to as the "Options Market Making Firms" or the "Firms") appreciate the opportunity to comment on the above-referenced rule filings by the respective exchanges, in connection with their roles as Self-Regulatory Organizations ("exchanges" or "SROs"). These rule filings propose a funding structure for the Consolidated Audit Trail ("CAT"). The Firms applaud the decision by the Securities and Exchange Commission ("SEC" or "Commission") to deny immediate effectiveness for these filings and to seek further comment, as well as the SEC's July 21, 2017 abrogation of Amendment No. 2 to the CAT National Market System ("NMS") Plan. As set forth below, the Firms urge the SEC to disapprove several elements of the proposed CAT funding model. The Firms write to make two separate points.

1) The Firms object to the particular disproportionate and inequitable allocation of Industry Member costs to options market makers ("OMMs") based on the proposed message traffic tiering structure. Although the proposal distinguishes between equity exchanges and options exchanges and weights equity exchanges as three times as significant as options exchanges, it makes no similar distinction between equity and options market-making firms. This is completely incongruent, and in the end, unfairly charges OMMs far more than similarly-situated equity market participants.

2) The Firms dispute the distribution of costs between SROs and Industry Members. The Firms object to the funding formula through which Industry Members pay 75% of the fees while Execution Venues pay only 25%. Just as troubling, within the Execution Venue category, the exchanges on the CAT Operating Committee have further determined that Execution Venue ATSs pay at least half of that 25%, with the result that the for-profit securities exchanges who have the sole voice in CAT governance are able to offload 88% of the CAT fees on their industry competitors while reaping all of the benefits of the CAT system for themselves.

The Firms, by way of background, comprise a group of OMMs that collectively represent one side of the trade in a substantial percentage of U.S. options industry volume. The proposing release estimates that eight Industry Members will be charged at the highest, Tier 1 rate. Most of the Firms signing this letter expect to be Tier 1 firms, and several of the Firms have multiple broker-dealer affiliates, with the result that these Firms would have to pay both a Tier 1 fee and additional large fees under the current funding proposal.

I. The Proposed Fee Structure for Industry Members Unfairly Discriminates Against Option-Market Makers

A. Charging for OMM Quote Changes Penalizes OMMs for the Structure of Option Market Itself.

First and most fundamentally, the proposed CAT cost allocation system unfairly charges OMMs based on the structure of the options market itself. Options of course are priced in significant part based on the price of the underlying equity security. But there are dozens or even hundreds of options series for each underlying equity security. For example, Facebook currently has approximately 420 different options series (counting both puts and calls, every different strike price, and every different expiration date). Many of these options series trade infrequently if at all, but an options market maker in a given security must quote two-sided markets in all of them. Generally speaking, the options market maker must do so on each of the multiple options exchanges in which it makes a market for the given options – and there are now 15 registered options exchanges. Consequently, the quoting task imposed by exchanges on OMMs is much greater than in equities. In other words, every time there is a significant trade execution in the equity markets for Facebook, an equity market-maker may be required to update a single quote. But the same execution in the equities markets may cause an OMM for Facebook to have to update hundreds of quotes, in each outstanding options series, on each of up to 15 different option exchanges – for a total of thousands of potential option quote updates across all markets. Counting quotes in the narrow-based and broad-based index options and ETF options for which Facebook is part of the underlying basket, a single Facebook equity execution actually may trigger thousands of additional options quote updates – each of which counts as a CAT Reportable Event for CAT fee purposes.

The Firms estimate that there will be over five OMM generated option quotes for every single B/D generated equity quote *and* trade record combined (approximately 20 billion option quotes vs. four billion equity quotes and trades).[1] As a result of the decision to treat each quote change in each options series as a CAT Reportable Event, the CAT plan has the effect of charging OMMS a "message" count for quote information duplicated on multiple exchanges with far less regulatory value than the order information from the equity market participants whose equity quotes and trades actually drive the options quote changes. Thus, basing the CAT fund proposal on the current definition of CAT Reportable Event discriminates unreasonably against OMMs because of the structure of the options market.

B. Charging for OMM Quote Changes is Inconsistent with How the CAT Funding Plan Distinguishes Between Equity Exchanges and Options Exchanges

The decision to treat all options quote changes as CAT Reportable Events for fee purposes is arbitrary, particularly when compared to how the exchanges that constitute the CAT Operating Committee are going to charge themselves. When it comes to themselves, the exchanges agree that the equities markets have a larger economic significance than the options markets; and, on that basis, the CAT Operating Committee has proposed a 75%/25% split between the equities and options markets for the Execution Venue portion of the CAT fees. In sharp contrast, those same exchanges propose that for broker-dealers, all messages (for both options and equities) be equal for purposes of imposing CAT fees. Of the 25% of the total CAT fees that the Execution Venues will pay, 18.75% is allocated to the equity exchanges (in two tiers based on volume), and only 6.25% is allocated to the options exchanges (again in two tiers based on volume). The equity versus options cost distribution model for the Execution Venues seeks to reflect the relative size of the equity and options trading markets in the US on the basis of market impact rather than message count. The CAT funding plan justifies this distinction as follows:

> First, the differing quoting behavior of Equity and Options Execution Venues makes comparison of activity between Execution Venues difficult. Second, Execution Venue tiers are calculated based on market share of share volume, and it is therefore difficult to compare market share between asset classes (i.e., equity shares versus options contracts).[2]

This is exactly the Firms' point – quoting behavior in the options markets and the equities markets is different, and should be treated differently in the CAT fee calculation. It is neither fair nor reasonable nor non-discriminatory (indeed, it is arbitrary and contrary to law) to treat the

[1] These volume estimates were made by taking the message numbers from the Consolidated Audit Trail – Request for Proposal dated March 3, 2014 and adding a conservative growth estimate for the respective products for the period from that time to January 1, 2018.

[2] File No. 4- 698, Exchange Act Rel. No. 80930. Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Amendment No. 2 to the National Market System Plan Governing the Consolidated Audit Trail at II.C (Execution Venue Tiering).

Options and Equities Execution Venues differently, but at the same time to treat OMM quote messages the same as equity messages. If the CAT Plan is going to distinguish between Equity and Options Execution Venues in calculating fees, then logically it must distinguish between equity market makers and OMMs as well. The Proposing Release does not even attempt to explain why it does not extend this obvious and logical distinction to OMMs.

Another unfairly discriminatory aspect of assigning 75% of CAT's total costs to broker-dealers on an equal message-cost basis is that the exchanges do not include the messages that the exchanges themselves generate. A majority of CAT option quote messages will be exchange-generated messages such as quotes from OPRA and top-of-book calculated quotes. While the OMMs will generate 20 billion option quote messages daily, the exchanges will generate over 30 billion "related" option quote messages – yet the exchanges have used the CAT Operating Committee to avoid charging themselves for the messages they generate. Once again, the CAT funding proposal discriminates unfairly in favor of the exchanges and against OMMs.

C. OMM Quote Changes Have Limited Regulatory Significance and the Fees Should Reflect This Fact

As discussed above, the decision to treat each option quote change as a full-charged CAT Reportable Event for fee assessment purposes will place most OMMs in higher tiers even though most of the quote messages will be redundant messages on as many as 15 exchanges trading the same option series. The Firms believe CAT expense allocations should include some emphasis on the regulatory value and utility of CAT data. The CAT funding proposal ignores the fact that the vast majority of option quotes have very little surveillance value (as compared to equities). The regulatory value of an option quote in a series that virtually never trades but is nonetheless quoted hundreds of times each day on 10 or 15 different options exchanges is much lower than equity messages that relate to actual trades.[3] The reason that the vast majority of OMM quote related messages have little post-trade surveillance value is dictated by options market structure. Less than 12% of option series trade on any given day and over 90% of all option trading activity occurs in less than 2% of the over 800,000 option series listed. For this reason, the vast majority of options quote changes have little significance from a compliance or surveillance perspective. In short, not all messages are of equal regulatory importance.

[3] This point is best appreciated by looking at the numbers. Approximately 820,000 option series are quoted each day, the vast majority on multiple exchanges, which leads to the estimate that some 20 billion OMM quotes will be submitted daily into CAT at commencement. Currently, about 94,000 of these series trade daily (slightly over 11% of the total series), but less than 15,000 series have daily volumes over 100 contracts. On average, the volume in these 15,000 series constitutes over 90% of the approximately 16 million contracts traded daily in options. In other words, there are over 1,500 option quotes disseminated each day for every options contract traded, while over 90% of the trading volume occurs in less than 2% of the series. As a result, there is little surveillance value in the vast majority of option quote changes, yet OMMs are being fully charged for each such message.

This is not to say that options are not important to the regulatory landscape, but rather, the point is that options are the tail and not the dog. As derivatives, options prices follow the prices set by the underlying equities. This means that from a regulatory utility point of view, equity prints are relied upon far more in regulatory reviews than are options prints; and, even more so, equity quotes are relied upon far more in regulatory reviews than option quotes. In this regard, the current CAT tiering approach is blind to the frequency with which a regulator will access CAT for equity information compared to options.

The Firms believe it is also mistaken to treat a quote change as interchangeable with an actual trade execution in the definition of a CAT Reportable Event. The size of the message traffic for a quote change (and thus the burden, if any, on the CAT system) is substantially smaller than the size of the message traffic for an order. A quote change message simply contains information about the price, time and size of the quote, plus the identity of the market maker which submits that quote. By contrast, a message about an order execution contains the same price, time and size information, but also must include information about the counter-party to the trade, as well as (in the case of partial executions or iceberg quotes) the remaining available size of quote. Moreover, quote messages do not need to be matched with other messages, as do order messages; and quote messages will not have complex-field requirements as do orders (e.g., handling instructions, order attributes and order types). Basically, order messages typically will be approximately twice the size of option quote change messages. Again, the stated goal of the CAT Plan is to align fees with actual costs. Defining CAT Reportable Events to treat quote changes the same as actual trade executions violates this fundamental principle, and therefore is unfair, unreasonable and discriminatory.

D. The CAT Funding Plan Should Not Charge for OMM Quote Changes Because They Are Not Actually Reported to CAT

OMM quotes are distinct from all other CAT Reportable Events in that OMMs are not actually required to report them to CAT. The Commission has granted exemptive relief under which OMMs are not required to report their quotes to CAT. The SEC granted this relief because options exchanges will already report those same quotes, and storing two sets of identical information would not justify the costs. Thus, these OMM quotes are the only exchange-facing messages which will not be stored. It would be arbitrary to count OMM quote changes as CAT Reportable Events for fee purposes, when in fact they will not be reported to or stored in the CAT system itself by the OMMs. These OMM quote changes impose limited if any costs on the CAT system, and yet (for the reasons discussed above) they will impose hugely disproportionate fees under the proposed CAT cost allocation. One of the fundamental principles in the Proposing Release is to align CAT fees with the anticipated costs that system usage will impose on the CAT system. By charging OMMs for message traffic that will be reported by options exchanges rather than OMMs to the CAT system, the Proposing Release is violating this basic principle that fees should be aligned with costs. The fee structure in the Proposing Release is unfair, unreasonable and discriminatory as applied to non-reportable quote changes by OMMs.

E. Charging for OMM Quote Changes Will Hurt Market Quality

Imposing additional and substantial costs on OMMs would further hinder the effective price competition needed to produce tight and liquid NBBOs in this fragmented options market. The reliance of the CAT Funding Model on a message traffic tier system virtually guarantees that the largest OMMs will be Tier 1 firms paying the highest possible CAT fee rate. As widespread press articles have reported, in the past year, trading volumes and revenues in the options markets have declined, and a number of formerly major OMMs (such as Interactive Brokers, JP Morgan and Citigroup) have pulled out of options market making entirely. In all but the most heavily traded options series, quoted spreads have been widening, thus costing investors more to trade. The burden for quoting in so many option series on a multitude of exchanges is borne primarily by the approximately 30 OMM firms that quote heavily on multiple exchanges. Academic studies consistently have shown that the ability of investors to hedge through options allows the market to more efficiently monetize and transfer risk, and results in narrower spreads, greater liquidity and lower cost of capital for issuers in the underlying equity markets. If the CAT Plan as proposed is successful at shifting a disproportionate amount of its costs on OMMs, the result will be further increased spreads, decreased liquidity, and decreased market maker participation in the options markets – all of which will harm both options investors and investors in the underlying equities.

A fundamental goal of the CAT NMS plan, as expressed in the Proposing Release itself, is "to avoid a reduction in market quality" (Proposing Release at n.24, internal quotes omitted). However, by treating every OMM quote change as a CAT Reportable Event, the proposal fails to achieve this fundamental goal – it will have a significant and disproportionate negative effect on options market quality. If OMMs were required to pay CAT fees based only on order executions and not on quote changes, they would still be upper-tier participants paying substantial fees to support the CAT system. This change would better align the CAT fees with the system's actual costs, would be more consistent with how Options and Equity Execution Venues are treated, and would avoid the negative effects on options market quality outlined above.

II. The 75%/25% Allocation Between Industry Members and Execution Venues Is Unfair and Unreasonable.

The Firms challenge the general proposal of the cost allocation framework in which the CAT Operating Committee (which consists entirely of exchanges) determined that 75 percent of total costs should be allocated to broker-dealer Industry Members, while the remaining 25 percent of costs are to be allocated to Execution Venues. Not only did the exchanges allocate to the Execution Venues only 25% of the costs, they also defined ATSs as Execution Venues, so that the exchanges' actual share of the costs of the CAT system will be less than half this amount. This proposed allocation is unfair, unreasonable and discriminatory.

The CAT NMS Plan has empowered a small group of for-profit, shareholder-owned exchanges, who control the CAT NMS Plan, to propose a cost and funding structure which impacts the entire industry, including many broker dealers against which the SROs increasingly compete for business. Those exchanges have proposed an inequitable structure which disproportionately pushes those costs onto the Industry Members. While the Firms acknowledge that the CAT system could be useful for certain regulatory functions, it is a costly approach to solving those problems. Meanwhile, there is no denying that exchanges will benefit from CAT functionality in a much more direct and tangible way than Industry Members. For these reasons, the Firms believe that the proposed funding model should be inverted, so that the Execution Venues should be required to pay 75% of the costs associated with CAT, with the remaining 25% coming from the broker-dealer community as a whole.

The Firms observe that the number of exchanges has been steadily increasing over the past 15 years. By contrast, the number of broker-dealers has fallen consistently every year for more than 15 years. As discussed above, the number of OMMs (the likely Tier 1 Industry Members) also has been declining. Having the exchanges pay for the majority of the costs of the CAT system would be a more stable and reliable long-term funding source for that system than relying on broker-dealers - and especially more stable than relying in substantial part on OMMs.

The Firms also agree with SIFMA that the Commission should require that, going forward, the exchanges conduct a detailed audit of their regulatory costs and funding sources to determine if the regulatory fees can be reduced in light of the cost-savings that CAT will provide. In addition, the Firms urge that for each new fee filed with the SEC relating to CAT, the CAT Operating Committee provide a detailed report identifying the associated regulatory costs, so that CAT fees can be better assessed for reasonableness. It is critical that CAT operate as a utility for the benefit of investors and the entire securities industry and not become monetized by the for-profit exchanges.

Conclusion

For the reasons set forth above, the undersigned firms respectfully request that the Commission disapprove the proposed CATS funding model. The Commission should require the CAT funding plan to exclude OMM quote changes (not associated with any trade execution) from the definition of CATS Reportable Events, or otherwise find a funding mechanism that does not unfairly discriminate against options market makers. The Commission should also require the CATS NMS Plan to impose a majority of the costs (the Firms suggest a 75%/25% split) on the exchanges which benefit most from the system, not on other Industry Members (including non-exchange Execution Venues). Only in this way could the Commission find that the CATS funding model is fair, reasonable and not discriminatory.

Respectfully submitted

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cc: Chairman Jay Clayton
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