



May 3, 2011

**By Electronic Mail**

Elizabeth Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: *Proposed Rule Change to Amend the Fee Schedule of the Boston Options Exchange Facility; File No. SR-BX-2011-020*

Dear Ms. Murphy:

Citadel LLC (“**Citadel**”)<sup>1</sup> appreciates the opportunity to submit this comment letter in response to the Boston Options Exchange Group, LLC’s (“**BOX**”) rule filing referenced above (the “**Rule Filing**”). The Rule Filing changed the BOX fee schedule for orders executed in a price improvement period (“**PIP**”) by increasing both the liquidity credit and fee for each transaction in the PIP from \$0.25 to \$0.30.<sup>2</sup> Citadel respectfully requests that the Commission suspend the operation of the Rule Filing and disapprove it because it unduly burdens competition and is inconsistent with the statutory requirements set forth in sections 6(b)(4), 6(b)(5) and 6(b)(8) of the Securities Exchange Act of 1934 (the “**Exchange Act**”).

**I. The Rule Filing**

In August 2010, BOX implemented a discriminatory pricing structure for its PIP auctions.<sup>3</sup> The Rule Filing magnified this discriminatory impact by increasing from \$0.25 to

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<sup>1</sup> On an average day, Citadel accounts for approximately 8-9% of U.S. listed equity volume, and 25-30% of U.S. listed equity option volume. Founded in 1990, the Citadel group of companies includes an asset management division that principally executes alternative investment strategies across multiple asset classes, and Citadel Securities that includes investment banking, a sales and trading platform, an industry leading market making franchise, and Omnium, a recognized administrator serving financial institutions. Citadel operates in the world’s major financial centers, including Chicago, New York, London, Hong Kong and San Francisco.

<sup>2</sup> Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Fee Schedule of the Boston Options Exchange Facility, Exchange Act Release No. 64198 (Apr. 6, 2011), 76 FR 20426 (Apr. 12, 2011).

<sup>3</sup> Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Amend Fee Schedule of the Boston Options Exchange Facility, Exchange Act Release No. 62632 (Aug. 3, 2010), 75 FR 47869 (Aug. 9, 2010) (the “**August 2010 Rule Filing**”). Citadel reiterates the comments it submitted to the Securities and Exchange Commission (the “**Commission**”) regarding the August 2010 Rule Filing (the “**Prior Citadel Letter**”). Comment Letter from John C. Nagel, Managing Director and General Counsel, Asset Management and Markets, Citadel LLC, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (August 30, 2010), *available at* <http://sec.gov/comments/sr-bx-2010-049/bx2010049-3.pdf>.

\$0.30 both the liquidity fee charged to participants that respond to a PIP auction (“**responders**”) and execute against a customer order, and the liquidity credit that is paid to participants that initiated a completed PIP auction (“**initiators**”).<sup>4</sup>

## II. Discussion

As described in the Prior Citadel Letter, the structure of fees and credits for PIP auctions is unreasonably discriminatory because it gives initiators a vast economic advantage over responders in executing against customer orders in PIP auctions. That is because the PIP auction liquidity fee and credit set off one another when an initiator executes against its own customer order, but responders are required to pay the liquidity fee with no offsetting liquidity credit.<sup>5</sup>

This structure is unduly burdensome on competition because it favors execution by initiators at the expense of responders, charging responders substantially higher fees and therefore reducing the economic incentive of responders to participate in PIP auctions. This reduces competition and hurts customers.

The fee structure also turns PIP auctions into a mechanism predominantly used to internalize customer orders. Initiators may submit customer orders to a PIP auction and face little or no competition from responders due to the higher fees responders are required to pay. This allows initiators to internalize customer orders at the national best bid or offer—reducing the very opportunity for price improvement that PIP auctions are supposed to provide.<sup>6</sup>

The Rule Filing would further intensify the discriminatory effect of this pricing structure and further limit competition by increasing the liquidity fee and liquidity credit. Under the existing fee structure, initiators already typically enjoy a \$0.40 per contract fee advantage over competitive responders when executing against PIP auctions.<sup>7</sup> The Rule Proposal would increase the liquidity credit to initiators by \$0.05 and increase the liquidity fee to responders by \$0.05, increasing the typical net fee advantage enjoyed by initiators to \$.45. This increase would create further incentive for initiators to internalize orders through PIP auctions and further reduce the economic viability of responder participation in PIP auctions.<sup>8</sup>

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<sup>4</sup> These fees and credits are in addition to the standard trading fees.

<sup>5</sup> In addition, there are volume discounts on trading fees available to initiators but not to responders.

<sup>6</sup> In April 2011, approximately 62% of PIP volume executed with no price improvement, in most cases simply allowing the PIP initiator to internalize customer order flow at the national best bid or offer.

<sup>7</sup> See Prior Citadel Letter at 3–4.

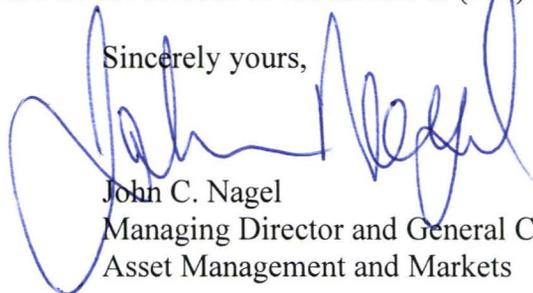
<sup>8</sup> Indeed, this advantage of \$.45 per contract is 50% greater than the largest fee that could be charged under the Commission’s proposed options market access fee cap, and the total fee charged PIP responders is almost double the proposed fee cap. See Proposed Amendments to Rule 610 of Regulation NMS, Exchange Act Rel. No. 34- (...continued)

We understand that some have argued that the BOX fee schedule is not unduly discriminatory because rebates should not be considered when comparing the fees charged PIP initiators and responders. This view results in bad policy, ignores economic reality, and is inconsistent with the way the BOX and the industry view these economic arrangements.<sup>9</sup> The impact and intent of the existing scheme, exacerbated by the Rule Filing, is to enable BOX participants that have customer order flow to trade against their customers at a much lower net fee than responders, to minimize competition from responders.

Finally, regardless of whether the Commission ultimately agrees with our analysis, Citadel respectfully submits that the Commission should recognize that this filing is not a mere “uncontroversial” fee filing. Rather, because it expands discriminatory pricing to an exorbitantly high levels and will have a broad impact on the options market, it should be subject to robust public comment and full Commission review.

If you have any questions, please do not hesitate to contact me at (312) 395-2100.

Sincerely yours,



John C. Nagel  
Managing Director and General Counsel  
Asset Management and Markets

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(continued...)

61902 (Apr. 14, 2010) (proposing a \$.30 per contract fee cap). The Commission proposed a fee cap, in part, to “preclude an options exchange from charging excessively high fees selectively”—precisely what the BOX Rule Filing is designed to accomplish. *Id.* at 23.

<sup>9</sup> PIP initiators receive a single invoice from BOX that nets liquidity rebates and execution fees.