GROUP ONE

TRADING

August 10, 2017

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

Re: File No. File No. SR-FINRA-2017-011; Self-Regulatory Organizations; Bats BYX Exchange, Inc; Bats BZX Exchange, Inc.; Bats EDGA Exchange, Inc.; Bats EDGX Exchange, Inc.; BOX Options Exchange LLC; C2 Options Exchange, Incorporated; Chicago Board Options Exchange, Incorporated; Chicago Stock Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; Investors' Exchange LLC; Miami International Securities Exchange, LLC; MIAX PEARL LLC; NASDAQ BX, Inc.; Nasdaq GEMX, LLC; Nasdaq ISE, LLC; Nasdaq MRX, LLC; NASDAQ PHLX LLC; The NASDAQ Stock Market LLC; New York Stock Exchange LLC; NYSE Arca, Inc. and NYSE MKT LLC; Suspension of and Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Changes To Establish Fees for Industry Members To Fund the Consolidated Audit Trail

Dear Mr. Fields:

Group One Trading, L.P. ("Group One" or the "Firm") appreciates the opportunity to comment on the above referenced proposed funding structures for the Consolidated Audit Trail ("CAT") filed by the Self-Regulatory Organizations ("SROs") that are the Plan Participants to the CAT NMS Plan and members of the Operating Committee of CAT NMS, LLC. Group One supports the decision by the Securities and Exchange Commission ("SEC" or "Commission") to deny immediate effectiveness and seek further comment. As discussed below, Group One urges the Commission to disapprove the CAT funding model as proposed.

In the Suspension of and Order Instituting Proceedings To Determine Whether to Approve or Disapprove the proposals, the Commission seeks comment on questions directly related to options market-makers. As an options market-maker, Group One can speak directly to how the options market-making community will be affected by these fees if implemented as proposed.

To begin, Group One does not believe that the proposal is an equitable allocation of reasonable fees under Section 6(b)(4) and Section 15(A)(b)(5) of the Exchange Act, and Group One supports and incorporates all of the arguments made in the July 28, 2017 comment letter submitted by Theodore R. Lazo, Managing Director, Associate General Counsel, SIFMA.

In response to some of the specific requests from the Commission, Group One's comments are as follows:

1) With respect to the proposed allocation of total CAT costs:

a) Commenters' views on the determination to allocate 75% of total CAT costs recovered to Industry Members (other than Execution Venue ATSs) and 25% to Execution Venues

Group One objects to the distribution of costs between Industry Members and Execution Venues, as there has not been any reasonable justification for an inequitable split between the Industry Members and the Execution Venues. It is particularly objectionable that the CAT Operating Committee is entirely comprised of members representing each one of the SROs; all of which are members of the Execution Venues group that receives favorable fee treatment under the proposed funding plan. In other words, these SROs—the vast majority of which are for-profit entities—were tasked with allocating fees, and disappointingly proposed an unreasonably favorable allocation for themselves, did so in the face of the objections from the Industry Members on the CAT Development Advisory Group ("CAT DAG", or "DAG"), and did so without providing reasonable explanation or justification. Additionally, including ATSs in the Execution Venue group has allowed for the members of the Operating Committee to further decrease their individual costs by increasing the number of members in the Execution Venue group. The result is that the allocated costs that fall on the members of the Operating Committee are disproportionately low and an outsized portion of the fees land on Industry Members.

Shifting this cost to participants is a shirking of the exchanges' business responsibility. Operating an execution venue—especially in the age of for-profit exchanges—necessarily comes with costs and compliance obligations, which the exchange must take into account with its pricing. Applying a fixed percentage of the cost to certain classes of participants prevents competitive forces from working.

b) Commenters' views on whether the proposed allocation of CAT Fees is consistent with the funding principles expressed in the CAT NMS Plan, which state that the Operating Committee shall seek, among other things, "to establish an allocation of the Company's related costs among Participants and Industry Members that is consistent with the Exchange Act taking into account . . . distinctions in the securities trading operations of Participants and Industry Members and their relative impact upon the Company resources and operations" and "to avoid any disincentives such as placing an inappropriate burden on competition and a reduction in market quality"

Group One believes that, if implemented as proposed, the funding model would serve to reduce competition, increase barriers to entry, and reduce market quality in the options markets. The options markets are very different from the underlying equity markets in that a quote-driven market place is necessary in the options space. The fundamental nature of options make this necessary; the complexity of exchanges and the nearly one million strikes available for trading require liquidity providers to act as an intermediary for natural customers. The essential function of an options market-maker is to provide publicly available indications of liquidity, thereby allowing market participants to reliably price their cost of execution before execution occurs. Group One believes that quoting is still important to the options market place, even with the shifting economics that has come with the rise in popularity of auction mechanisms; however, the proposed funding model represents a large fixed cost tied to posting executable quotes at a time when the number of registered market-makers in the options industry is declining. By linking a massive fixed cost to that activity, the market is disincentivizing an activity it should value, and it is increasing the cost threshold for market makers to stay in business.

The fees in the proposed funding model are effectively a penalty for providing an essential service to the marketplace. The proposed fees on options market-makers are excessive, reaching into the hundreds of thousands of dollars per year. One of the market structure issues that the industry struggles with now is the widening of quotes due to increased traffic in auctions. NBBO quotes are still the benchmark for measuring execution quality amongst retail order firms, and any degradation in quote quality immediately impacts customer fills. Group One will account for the assessment of those fees explicitly by increasing the width of its posted markets, and the Firm believes its competitors will do the same. Any unreasonable fee assessed upon options market-makers will force markets to widen, and the cost will therefore ultimately be borne by the investors.

4) With respect to the proposed CAT Fees for Industry Members:

a) Commenters' views on the determination to include options market-maker quotes in message traffic for purposes of calculating the appropriate fee tier for options market-makers

Group One believes the proposed treatment of quotes in the Proposal is wholly unfair to the options market-making community. The message traffic generated by options market-makers is a direct result of the market structure created by the SROs. Strike proliferation and exchange proliferation are two consequences of this market structure which have a direct bearing on how many quotes options market-makers send.

The majority of the options industry volume is concentrated in less than 2% of the total options series listed; however, the SROs continue to list as many strikes as possible for trading and options market-makers are forced by rule to quote an ever-increasing number of series just to meet the Exchanges' requirements. Exchanges attract business in many ways, and one of those ways is by competing to accommodate requests for new listings. Often, customers encourage Exchanges to list as many strikes as possible because there is no cost to them associated with doing so. The result is that Exchanges are willing to list any strike request made, regardless of how likely the request is to lead to an execution, despite consistent objections by market-makers that many series are not economically necessary. Further, in a field of 15 execution venues, they each compete for differentiation, and the non-standard listing of new strikes creates significant overlap, with both dollar and half strikes existing across infrequently traded products.

Quotes are an imprecise measure of the economic activity that the CAT should attempt to monitor. Across the 3000 issues listed in the industry today, there is a vast difference in messaging traffic as a function of volume. Over 30% of listed issues trade zero contracts on a given day, and 43% of issues trade less than 10 contracts a day, yet millions of messages are generated to keep market-makers in compliance with exchange obligations and to be poised for opportunity. With no sensible delisting policy, or an alternative mechanism to attract volume, liquidity providers are being taxed on a metric that has little bearing on relevant activity.

As an example, iShares iBoxx $ High Yield Corporate Bond ETF (“HYG”) currently has 710 series across 21 expirations listed for trading, and market-makers with an appointment in this symbol need to update both the bid and ask for both calls and puts. At a minimum, a market-maker is required by rule to quote 60% of the series listed on the exchange where the market-maker carries the appointment. This means that any options market-maker with an appointment in HYG must have, at a minimum, 1704 live quotes in the marketplace on every exchange where that market-maker has an appointment. HYG is also listed for trading on all 15 options exchanges. For a market-maker to have full coverage of all listed series in HYG across every options exchange, that market-maker must have 42,600 live quotes available for execution in the marketplace and each one needs updating every time a pricing input changes—something that happens continuously throughout the day.

HYG is illustrative of how options market-makers have come to generate their current levels of message traffic. Of the 710 series listed for trading in HYG, 310 do not have any open interest at all in either of the calls or puts in that series. Every single day, options market-makers are required by rule to quote series that no one is interested in trading, but, currently, there is no mechanism to systematically delist options with zero open interest. The risk associated with having this many executable quotes in the market place is a risk that market-makers have learned how to deal with, but, under the proposed funding model, there is a disproportionate increase in cost being pushed onto options market-makers simply for providing liquidity in options series that were not requested and were forced upon the options market-makers by the SROs.

In addition to strike proliferation, the number of exchanges that market-makers are effectively required to post liquidity on has risen to 15. Although Group One’s choice of which exchanges to join and stream two-sided quotes is ultimately a business decision, competitive dynamics force the Firm’s hand, and the Firm suspects those dynamics force the hands of competitors as well. Group One feels that not being present on every exchange is the surest way to miss order flow, and in order to recoup their enormous fixed costs, options market-makers are effectively required to have a presence on all exchanges.

Options market-maker quotes are an inappropriate basis for the calculation of fees to be allocated to market-makers, as the amount of those quotes (and therefore the fees driven off those quotes) is not only out of the market-makers’ control but has been established over their objection. If options market-makers need to be charged based on the amount of quote message traffic generated, the Firm urges the Commission to undertake a holistic review of strike listing policy and the current number of exchanges with the goal of determining if the market place is well-served by the current state of each.

The Firm also notes that there is a large difference in the complexity of quote messages in the options industry as compared to the possible permutations of order messages in the equities space, and that the difference was not accounted for at all in the CAT’s proposed pricing. Group One believes that some measure of complexity should be accounted for in the funding model, as that will ultimately end up being a large factor in the overall cost of building, operating, and maintaining the CAT. While the message count from options market-makers is high, the complexity of the messages is very low. These messages leave the options market-maker’s system and go directly to the Exchange. These messages are the most straightforward traffic handled by the CAT processor. In contrast, the routing of an equity order for execution can be incredibly complex, and that does not appear to have been factored into the funding model. As a member of the CAT DAG, Group One directly participated in discussions about how the CAT will need to handle the most complex scenarios. The DAG identified six “standard” execution scenarios (order executed on agency basis; order executed on riskless principal basis; broker to second broker algorithmic system; retail firm routing to wholesale broker-dealer for handling; order executed as principal via internal ATS; and partially executed order with cancel and allocations), and, within the order executed on agency basis scenario, there are an additional six scenarios to account for post-trade order handling (order allocated to HIC account; order allocated to DVP account settling at prime broker; order with step out to carrying clearing broker; order executed with non-self-clearing executing broker allocated to DVP account at clearing broker settling at prime broker; order executed via introducing broker and held at carrying clearing broker; and order executed via introducing broker with allocation to DVP account settling at prime broker). However, the most complex of those executions might only result in single report to the CAT, resulting in a low fee assessment to a market participant that is creating and contributing to a complex audit trail. It is these complex workflows that drive a disproportionately high amount of the costs for the CAT processor, and the proposed funding model vastly underestimates the true impact of orders and focuses on high message count generated by options market-makers.

In conclusion, Group One believes that proposed CAT funding model has been arbitrarily determined and unreasonably proposed. Further, we feel the model is particularly discriminatory and unfair to options market-makers. For the reasons explained above, Group One respectfully requests that the Commission disapprove the proposed CAT funding model.

Respectfully submitted,

John Kinahan

John Kinahan
Chief Executive Officer
Group One Trading, L.P.