Brent J. Fields, February 17, 2017

Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: NYSE Arca Options Fee Filing;
File No. SR-NYSEArca-2017-12

Dear Mr. Fields:

Cutler Group, L.P. ("Cutler") [i] appreciates the opportunity to respond to the Securities and Exchange Commission (the "Commission") and comment on the proceedings to determine whether to approve or disapprove the above referenced rule filing by NYSE Arca Options (the "Exchange").

Cutler recommends that the Commission suspend and disapprove the Exchange's proposal to amend the Exchange's fee schedule. Cutler recommends that the Commission disapprove the fee schedule change because – as described more fully below - the fee schedule proposed by the Exchange would establish a material credit differential among market participants that is inequitable, unfairly discriminatory, and unduly burdensome on competition. Moreover, we recommend the Commission conduct a broad review of preferred pricing rules and volume-based and affiliated order incentive programs applied by all options exchanges as the Exchange's proposal is part of an industry-wide problem.

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I. Background

The Exchange seeks to increase the credit received by some participants when trading Non Penny Pilot issues. We believe that the magnitude of the credit is illegal and that the conditions to achieve the credit are also illegal. Furthermore, we believe that this rule will suppress liquidity within the National Market System.

Securities and Exchange Act of 1934

Sec. 6. (b) An exchange shall not be registered as a national securities exchange unless the Commission determines that—(4) The rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

From Merriam-Webster dictionary - equitable is defined as *"dealing fairly and equally with all concerned".*

From the Exchange "the proposed Non-Penny Incentive is reasonable, equitable, and not unfairly discriminatory because it would be **available** to all Market Makers on an equal and non-discriminatory basis, in particular because it offers alternative means to achieve the same credit."

In other words, the dictionary says equitable is equal for **all** concerned. The Exchange says this rule is "equitable" because it is **"available"** to Market Makers on an "equal" basis.

Equitable means everybody gets a fair deal. The Exchange argues it means everyone gets a fair deal if they have an “equal” chance to make the right changes to get the fair deal. Obviously this is not what is generally meant or understood by words like “equity” or “equitable”.

By the Exchange’s logic it would be equitable for Market Makers in New York to pay lower fees than other Market Makers because moving to New York is "available" to all Market Makers on an "equal" basis.

Further since there is no way to know how many or if any participants will make the changes, then the Commission in enforcing the Act is forced to enforce the tests within it on the actual fee differential proposed – rendering the Exchanges arguments of availability mute.

However, because we do not presume to understand the mindset of the Commission we will discuss further specific inequities within this rule.

II. Conditions to Receive the Credit

The Exchange proposes that:

> *a Market Maker would be eligible for a $0.55 credit for Posted Electronic Market Maker Executions in Non Penny Pilot Issues provided the Market Maker achieved (1) at least 0.55% of TCADV from Market Maker Posted Orders in All Issues, or (2) at least 1.60% of TCADV from all orders in Penny Pilot Issues, all account types, with at least 0.80% of TCADV from Posted Orders in Penny Pilot Issues.*

If not qualifying for this incentive, a NYSE Arca Market Maker order would receive a $0.05 credit for posted electronic executions and a Lead Market Maker order would receive a $0.40 credit, in Non Penny Pilot Issues. Therefore, the credit differential between participants could be as high as $0.50.

In order to qualify for this credit, a market maker must *de facto* transact a significant amount of volume in issues outside of the Non Penny Pilot set (i.e. in unrelated issues to which the credit does not apply). This is explained below.

The first condition qualifies participants that achieve "*at least 0.55% of TCADV from Market Maker Posted Orders in All Issues*." However in January 2017, 0.55% of TCADV exceeded 66% of average daily market maker volume executed on the Exchange in Non Penny Pilot issues.[ii] Therefore it would be practically impossible for a market maker to achieve 0.55% of TCADV on NYSE Arca by trading only Non Penny Pilot issues. Thus, the first condition only qualifies participants that conduct significant volume in unrelated issues.

The second condition explicitly excludes volume conducted in Non Penny Pilot Issues. Thus, the second condition only qualifies participants that conduct significant volume in unrelated Penny Pilot issues.

The Exchange also notes “the calculations for the qualification thresholds for the proposed Non-Penny Incentive would apply solely to electronic executions and would include transaction volume from the Market Maker’s affiliates or its Appointed OFP.”

There are no other conditions by which a market maker could qualify for the $0.55 credit.

A market maker that posts electronic liquidity in Non Penny Pilot issues cannot qualify for the credit by improving liquidity added in those issues. Due to the transaction volumes required, a market maker must conduct significant volume in unrelated Penny Pilot issues in order to qualify for this credit. However, competition in Penny Pilot issues (unlike that of Non Penny Pilot issues) requires both advanced proprietary technology and significant capital investment that will not be available to some market makers of Non Penny Pilot issues. Therefore, some market makers of Non Penny Pilot issues will be unfairly excluded from receiving this credit.

We believe that most Market Makers who meet the criteria will do so in part by routing customer order flow on behalf of other brokers (affiliated order flow). Becoming an executing broker (sometimes referred to as aggregator) is a scale, capital and relationship intensive business; in other words, something very different than being a middle or smaller size Market Maker. Further, even if a Market Maker was willing and able to make the investments necessary, there is no requirement that customer brokers choose any particular executing broker. In fact, we believe customer brokers may prefer to work with a single or small set of execution brokers, because using a small set simplifies their business, making it difficult to almost impossible for any new entrant to enter into that business.

Therefore, even though we are confident it is illegal to even consider the contingencies that are required to be treated equitably under this rule, we point out that the conditions themselves to qualify for the $.55 credit as applied across participants are onerous, inequitable and unfairly discriminatory. In the Exchange's words, they are clearly not 'available equally'. Many smaller participants have realistically a virtually zero percent chance of making these tiers.

III. The Equity of the Credit

Some synonyms for equitable are fair, just and impartial. By definition equitable cannot mean that a certain subset of those considered get treated equitably and others don't. Therefore, we must conclude that the intention of those writing the Act, was that all "members and issuers and other persons using its facilities" are treated fairly, justly and impartially.

In that light, what reasonable justification is there for any fee difference at all? The most tenable, obvious and fair position for the Commission to take is - none. Any fee difference is going to hit some participants unequally (by definition) which is exactly the opposite of equitable as it is defined in Merriam-Webster.

If the Commission were to disagree, then to meet the requirements of the Act there must be a fair, just and impartial reason for the difference and for allocations to some participants over others.

We simply do not see anything that is fair, just or impartial in allocating higher fees (or lower rebates) to smaller Market Makers, Market Makers not trading penny pilot names and Market Makers not bringing affiliated order flow to the Exchange.

Tellingly the Exchange does not even make an attempt to argue that the fee differential itself is equitable (except for the previously discussed "available" argument). For fees to be allocated and charged differently across participants there must be some fair, just and impartial reason. The Exchange offers no reasonable justification in this regard.

It is our belief that gross profit margins industry wide are somewhere between $.75 - $1.75 per contract and net profit margin per contract less than 50% of this.

Therefore, a $.50 credit differential (between $0.05 and $0.55) is very high. It could easily be the difference between profit or not. Not only is the fee difference probably illegal, and definitely not justified by any fair, just or impartial logic; it is massively high relative to levels of revenue and profitability.

IV. Impact on Competition

The credit differential will suppress competition among market makers, because it grants a significant economic advantage to market makers that are able to qualify for the credit. It will allow qualifying market makers to quote at prices that are unaffordable to non-qualifying market makers. Market makers that cannot conduct significant unrelated business in Penny Pilot issues will be forced to quote at prices behind the quotes of other market makers. Ultimately, this could lead to: (1) reduced volume displayed at the Exchange BBO, as non-qualifying market makers cannot quote at the BBO; (2) reduced competition among market makers, as non-qualifying market makers will be unable to transact volume necessary to support business activities; (3) wider spreads provided to customers, as competition among market makers is reduced.

Volume-based and affiliated order incentive programs tend to suppress competition among market makers by fortifying the economic advantages of the largest market makers. Each incentive program provides a financial advantage. A market maker that receives such advantages can reinvest that money into further capitalizing its business activities. By providing advantages at discrete qualifying thresholds, volume-based and affiliated order incentive programs direct resources only to participants that already have significant human, technical and capital resources, rather than to participants that would most efficiently deploy new resources. In this way, volume-based and affiliated order incentive programs create barriers to entry for new participants, and marginalized smaller Market Maker are gradually forced from the business. Any surviving small market makers will be disadvantaged while conducting business experiments with new technology and new ideas. Certain technical advances in market making may never be attained, due to these artificially created barriers to entry.

V. Motivation

The Exchange states “that it operates in a highly competitive market in which market participants can readily favor competing venues. In such an environment, the Exchange must continually review, and consider adjusting, its fees and credits to remain competitive with other exchanges.”
In other words, this rule seems to be motivated by the economics of Exchange itself. And the Exchange seems to asking for special consideration of the rule based on its economic position. We would simply state the obvious – that the Act in no way contemplates or considers the economics of the Exchange. The tests within the Act must be met on the surface regardless of the consequence to any particular exchange.

VI. Complexity

One sentence from the rule - “As proposed, a Market Maker would be eligible for a $0.55 credit for Posted Electronic Market Maker Executions in NonPenny Pilot Issues provided the Market Maker achieved (1) at least 0.55% of TCADV from Market Maker Posted Orders in All Issues, or (2) at least 1.60% of TCADV from all orders in Penny Pilot Issues, all account types, with at least 0.80% of TCADV from Posted Orders in Penny Pilot Issues.”

We urge the Commission to consider – why is it so complicated? We will posit that the Exchange has thought through which entity or specific group of entities it wants to target with these tiers in order to get those entities to shift their behavior. Or if not that, they have at least a very narrow and specific set of characteristics they are targeting - evident directly by the complexity and requirements of the rule - and with that will favor a very narrow set of firms.

We ask - how can finely targeting a fee advantage to a narrow set of entities ever be consistent with equitable and non-discriminatory? It's a complete contradiction.

VII. Exchange Act

The credit set forth in the proposed rule change renders it inconsistent with Exchange Act Section 6(b)(4), which requires that rules of a national securities exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members, Section 6(b)(5), which requires exchange rules not be designed to permit unfair discrimination among participants, and Section 6(b)(8), which requires exchange rules not impose any undue burden on competition. Given these inconsistencies, the Commission should disapprove the proposal.

VIII. Discussion

The intention of the Act is obvious - the securities industry must operate under just, equitable, non-discriminatory, free and open principles.

The primary intention of the Exchanges is also obvious (and the Exchange participants for that matter) – to make money.

These two things have run headlong into each other. Since the Exchanges have become for-profit institutions the rule books have exploded. The Exchanges are motivated to add rules beneficially targeting entities that bring them order flow or volume in some way. However, rules benefiting some participants over others are in contradiction to US law. The Commission is the arbitrator and must see through these conflicts and assure US law is clearly enforced.

The number of Market Makers has decreased dramatically over the last 15 years, and concentration appears to have increased for those that remain. There is also evidence of increases in bid/offer width. We are confident that in part this is caused by the skewed fee sets at the various Exchanges.

Fairness and equity could arguable be meant to imply that smaller Market Makers because of scale disadvantages should be given a fee advantage. But we are not suggesting that. However, similarly the large and powerful should not be given special preferences outside of the law. This is for certain. The fact that it has gotten this far seems blatantly wrong.

All we are suggesting is a fair, level playing field – exactly what is promised by the Act. We believe all Market Makers should pay the same fees. We believe that is what is required by US law and that is what is right and fair. It is also what will lead to a healthier and competitive industry state and therefore the most fair, competitive and aggressive pricing for customers.

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Thank you for considering our comments. We would be pleased to discuss these issues in greater detail. If you have any questions, please do not hesitate to contact us ([redacted] or [redacted]).

Sincerely,

Trent Cutler, Alex Fontana, Anand Prakash

Cutler Group, LP

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[i] Cutler Group, L.P. or our predecessors have been an NYSE Arca Options participant for 25 years.

[ii] In January 2017, TCV was 273,965,176 contracts. Also in January 2017, NYSE Arca Options market maker volume in Non Penny Pilot issues was 2,260,919 contracts. The latter can be computed by joining OCC data (http://www.theocc.com/webapps/volume-query) with an indicator of which issues are in the Penny Pilot. Therefore, 0.55% of TCV is 1,506,808, or 66% of NYSE Arca Options market maker volume in Non Penny Pilot issues. Since some (possibly most) market maker volume is not posted on the Exchange, the metric 0.55% of TCV must certainly exceed Market Maker Posted Orders volume in Non Penny Pilot issues by an amount greater than 66%.