

March 20, 2017

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

**Re: NYSE Arca Options Fee Filing;
File No. SR-NYSEArca-2017-25**

Dear Mr. Fields:

Cutler Group, L.P. ("Cutler") appreciates the opportunity to address the Securities and Exchange Commission (the "Commission") by commenting on whether to approve or disapprove the above referenced rule filing (the "Proposal") 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, because it violates Section 6 of the Securities Exchange Act of 1934. The Exchange's proposal is both unfairly discriminatory and burdensome on competition.

Background

The Proposal grants some Market Makers ("MMs") a rebate as high as \$0.82 per contract for posting electronic liquidity. Smaller MMs will continue to earn the base rebate of \$0.05 per contract for posting electronic liquidity in the same instruments. Thus, the Exchange has introduced a price advantage of \$0.77 (\$0.82 - \$0.05) between its most-favored and least-favored MMs. Prior to the Proposal, the largest price advantage granted by the Exchange between MMs in electronically posted liquidity was \$0.50, introduced by the Exchange in February 2017.ⁱ Prior to the recent introduction of that \$0.50 advantage, we believe that no National Market System exchange offered an advantage between MMs in electronically posted liquidity of greater than \$0.40, recently introduced by MIAX Pearl.ⁱⁱ

Cutler is currently registered as a Lead Market Maker ("LMM") on the Exchange for roughly 580 classes, and Cutler is registered as a regular MM on the Exchange for many more classes. Cutler's primary approach towards trading on the Exchange is to provide liquidity in tradable instruments that would otherwise be underserved by the Exchange's MMs. As a member of the Exchange, Cutler must compete with larger firms that are more oriented towards high-frequency trading.

Cutler has a long history of market making on the Exchange. Cutler was one of the first LMMs on the Exchange and has had a floor presence of 10-25 traders since the mid-nineties. Trent Cutler became a member of the Pacific Coast Exchange (now NYSE Arca Options) in 1991.

On Feb. 17, 2017, we submitted a comment letter to the Commission, recommending that SR-NYSEArca-2017-12 be disapproved.ⁱⁱⁱ We believe that both SR-NYSEArca-2017-12 and SR-NYSEArca-2017-25 should be disapproved for the same reason: they introduce price discrimination that is both unfair and burdensome on competition.

Statutory Violation

The Securities Exchange Act of 1934 requires that the Exchange's rules must "provide for the equitable allocation of reasonable dues, fees, and other charges"^{iv} and that the rules "are designed ... to promote just and equitable principles of trade... to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers."^v Furthermore, the Exchange must not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title."^{vi}

The Proposal clearly violates the Securities Exchange Act of 1934. The \$0.77 price advantage between MMs is so great that it must be considered neither equitable nor reasonable. It codifies a regime of unfair price discrimination between MMs. It will impede free and open markets, by effecting a transaction tax that is only paid by some MMs. It burdens competition, by impairing the ability of many participants to maintain their competitive standing. All of these problems are forbidden by Section 6 of the Securities Exchange Act of 1934

We emphasize that a \$0.77 price advantage between MMs is monumental. It nearly doubles the greatest such advantage that was available one year ago. Interactive Brokers' recent 2016 10-K, stated that market making net profit per contract was \$0.14.^{vii} Therefore, the Proposal codifies a form of price discrimination that is greater than five times the return of a moderately sized MM. The Proposal's claim to maintain all market participants' competitive standing is patently false. More likely, any MM at a \$0.77 pricing disadvantage to other MMs would fail with near certainty (whether through rebate or fee difference).

On March 8, 2017, Interactive Brokers announced that they will discontinue MM operations globally because they no longer see it as a profitable activity.^{viii} In this way, we believe that the Proposal and other similar forms of price discrimination are contributing towards serious failures to promote the mechanism of an open market.

Misleading Nature of Rule Filing

The Exchange has not included its base MM rebate anywhere in the Proposal. This important omission gives a misleading impression that the greatest price advantage after the Proposal will be \$0.50 (\$0.82 - \$0.32). However, the Proposal does not increase or eliminate the \$0.05 base rebate. In this way, the Proposal subtly increases the greatest price advantage between MMs to \$0.77, rather than leaving it at an already unfair rate of \$0.50.

Price Discrimination as a Business Strategy

The Exchange's head of options recently observed that the Exchange's primary business does not offer a unique service to the market, and that this problem has forced them to be concerned with advertising a tight BBO.

"[M]any of the offerings have largely been undifferentiated... At the end of the day, we're a quote driven market and our quote is our advertisement. To the extent that those quotes become wider, that's an area of concern for us."^{ix}

The Exchange's CFO recently observed that that the Exchange seeks to maximize profit while paying particular attention to a "small handful of MMs."

"So, in that environment, you have one or two choices, you can play a market share game and cut fees in order to talk about market share or you can try to maximize your business towards earnings potential and that's what we're doing, is the latter... The market has, at its core, a small handful of MMs that are very, very important to this country and to those markets, but those people are very sophisticated, they can move their business around that will, they use algorithms to maximize their profitability. And so, you've got to attack that market in a way that defines your business and as you can see, consistent through the presentation today, we're really looking for earnings per share growth long-term for our shareholders."^x

In other words, the Exchange seeks to advertise a tight BBO without reducing fees for all participants. The practical consequence of this strategy is revealed in the Proposal. The Exchange advertises a tight BBO by subsidizing some quotes with \$0.82 rebates, but the Exchange targets these large rebates only towards its most sophisticated MMs. Meanwhile, the Exchange maximizes earnings by charging its remaining non-Customer participants significantly higher transaction costs.

This is an interesting business strategy; however, it is expressly forbidden by the Securities Exchange Act of 1934. Because the Exchange is a participant in the National Market System, the Exchange has certain obligations that supersede maximizing earnings potential, i.e. the Exchange is obligated to conduct business fairly.

Concluding Remarks

Market Making participants operate in a tremendously competitive environment and are acutely affected by fee differences such as those proposed under the Proposal. Furthermore, unlike the Exchange, the participants are guaranteed under the Act a just and equitable competitive environment which notably is not contemplated for the Exchange itself.

The Exchange has a unique standing as a Self-Regulatory Organization and rule maker. Because of that, it must first and foremost fulfill its duties under the law to provide a just and equitable marketplace. This is beyond debate, and it is clear that the Proposal does not meet those standards.

Thank you for considering our comments. We sincerely hope the Commission can see through the various self-interests to return the industry to a fair, level, equitable, free and open playing field - exactly what is contemplated within the Act. A simple first start would be not approving any more violations of those concepts such as the Proposal (SR-NYSEArca-2017-25).

Sincerely,
Trent Cutler, Alex Fontana, Doug Patterson, Anand Prakash
Cutler Group, LP

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- ⁱ SR-NYSEArca-2017-12. <https://www.sec.gov/rules/sro/nysearca/2017/34-80029.pdf>
- ⁱⁱ Pearl Market Makers receive between \$0.70 and \$0.30 when posting in Non-Penny Classes. https://www.miaxoptions.com/sites/default/files/page-files/MIAX_PEARL_Fee_Schedule_02132017.pdf
- ⁱⁱⁱ <https://www.sec.gov/comments/sr-nysearca-2017-12/nysearca201712-1589298-132149.pdf>
- ^{iv} Securities Exchange Act of 1934, Section 6(b)(4)
- ^v Securities Exchange Act of 1934, Section 6(b)(5)
- ^{vi} Securities Exchange Act of 1934, Section 6(b)(8)
- ^{vii} IBKR Market Making contracts traded 307,377,000. IBKR Market Making net profits \$44,000,000. <https://www.sec.gov/Archives/edgar/data/1381197/000104746917001069/a2231013z10-k.htm>.
- ^{viii} <https://www.interactivebrokers.com/en/index.php?f=24473>
- ^{ix} <http://www.johnlothiannews.com/2016/06/young-gun-ivan-brown-likes-historical-biographies-insights-regarding-new-head-nyse-options/>
- ^x <http://ir.theice.com/~media/Files/l/lce-IR/events-presentations/transcript/4q-transcript-v2.pdf>