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September 16, 2016

Via Electronic Mail

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

Re: NYSE Amex Options Fee Filing;
File No. SR-NYSE MKT-2016-045

Dear Mr. Fields:

KCG Holdings, Inc. ("KCG")[1] 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 MKT LLC (the "Exchange").[2]

KCG supports the Commission's decision to temporarily suspend the Exchange's proposed rule change and to institute proceedings to determine whether to approve

[1] KCG is a leading independent securities firm offering investors a range of services designed to address trading needs across asset classes, product types and time zones. As an electronic market maker, KCG commits its capital to facilitate trades by buyers and sellers on exchanges, ATSs, and directly with clients. We combine advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices. KCG has multiple access points to trade global equities, fixed income, currencies and commodities through voice or automated execution.

[2] *See* Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Modify the NYSE Amex Options Fee Schedule with Respect to Fees, Rebates, and Credits for Transactions in the Customer Best Execution Auction, Exchange Act Release No. 78029 (June 15, 2016) ("Suspension Order"); *See also* Notice of Filing and Immediate Effectiveness of Proposed Rule Change Modifying the NYSE Amex Options Fee Schedule, Exchange Act Release No. 77658 (April 26, 2016)("proposed rule change" or "proposal").

or disapprove the proposal. Auction fee structure is a critical issue facing the options market that necessitates careful analysis and review by the Commission. KCG recommends that the Commission disapprove the rule change because – as described more fully below - the fee structure proposed by the Exchange would establish a material fee differential among market participants that is inequitable, unfairly discriminatory, and unduly burdensome on competition. Moreover, we recommend the Commission conduct a broad review of the fee structures applied by all options exchanges to their auction mechanisms as the Exchange's proposal is symptomatic of an industry-wide problem.

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I. BACKGROUND

A. The Proposal

The Exchange's proposal would modify the NYSE Amex Options Fee Schedule for certain fees, rebates, and credits relating to executions through its Customer Best Execution Auction ("CUBE Auction") in the following significant respects:

- ***Increase fees for auction responders*** from $0.12 to $0.70 for Penny classes and from $0.12 to $1.05 for Non-Penny classes, per executed contract, while leaving fees for initiating participants unchanged at $0.05;
- ***Increase rebates paid to initiating participants*** that meet certain requirements from $0.05 to $0.18 for each of the first 5,000 customer contracts of an agency order executed in a CUBE Auction, which would yield a net rebate of $0.13 per contract; and
- ***Raise "break-up" credits paid to initiating participants*** by the Exchange from $0.05 per contract in all classes to $0.35 for Penny classes and $0.70 for Non-Penny classes.

Taken together, these proposed changes dramatically increase fee differences among CUBE Auction participants based solely on participant type. As noted by the Commission, the potential disparity between auction initiators and responders would be $0.83 for Penny classes (based on a $0.70 fee for responders compared

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with a $0.13 net rebate for initiators) and $1.18 for non-Penny classes (based on a $1.05 fee for responders compared with a $0.13 net rebate for initiators).[3]

B. The Commission's Suspension Order

The Commission, on its own initiative and citing the public interest and the protection of investors as grounds, determined to temporarily suspend the Exchange's proposed rule change and to initiate proceedings to determine whether to approve or disapprove the proposal.[4] The Commission's Suspension Order highlighted numerous concerns with the filing, including how the Exchange failed to address what the Commission viewed as a "key aspect" of the proposal - how the proposed fee structure would "substantially exacerbate" the fee differences between initiating participants and non-initiators and the potential negative effect of such differences on the operation of the CUBE Auction and the potential for customer price improvement.[5] The Commission also raised direct questions about whether the Exchange's proposed fee structure was consistent with the statutory requirements applicable to a national securities exchange under the Securities Exchange Act of 1934 (the "Exchange Act") – specifically, Exchange Act Sections 6(b)(4), 6(b)(5) and 6(b)(8) - and requested industry feedback on all relevant issues related to the proposed rule change.

C. The Exchange's response to the Suspension Order

The Exchange submitted a comment letter in response to the Commission's Suspension Order.[6] Notably, the Exchange did not dispute or respond to the Commission's concern that the proposed fee structure may be inconsistent with the statutory requirements applicable to a national securities exchange.

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[3] Suspension Order at 4-5.

[4] Suspension Order at 5-6.

[5] Suspension Order at 4.

[6] *See* Letter from Elizabeth King, General Counsel and Corporate Secretary, New York Stock Exchange, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, dated July 8, 2016 ("NYSE Response").

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The Exchange did, however, provide insightful context surrounding its adoption of the CUBE Auction in 2014. The comment letter made several points clear, including: (i) the Exchange adopted an auction mechanism to compete with its options exchange peers and believes it must continue to tweak its fee structure to remain competitive with them; and (ii) the Exchange supports a broad review by the Commission of the fee structures applied by all options exchanges. The Exchange also stressed its long-held belief that options markets auctions should guarantee price improvement and that the implementation of auction mechanisms that do not require price improvement have contributed to the erosion of liquidity at the NBBO.[7]

II. Discussion

A. The options auction process is important

To be clear, KCG supports the concept behind options auction mechanisms. Option exchange rules historically permitted a firm to trade with its own customer's order only after an auction during which other members of that market had an opportunity to participate in the trade at the proposed price or an improved price.[8] As noted by the Commission, this type of auction process provided some assurance that the customer's order was executed at the best price any member in that market was willing to offer. Recent implementation of auction fee schedules by options exchanges, however, are outstripping the ability of many market participants to participate in auctions and frustrating the goals of fostering member participation and price improvement.

B. The current fee structures applied by options exchanges to their auctions mechanisms are flawed

We are concerned that the current fee structures applied by the exchanges to their options auctions run contrary to goals underlying the Commission's initial approval of auction mechanisms for options markets, which was to provide a process for customer price improvement and for members to participate in the trade at the

[7] *See* NYSE Response at 2.

[8] *See* Competitive Developments in the Options Markets, Exchange Act Release No. 49175 (Feb 9, 2004).

proposed price or an improved price. The fee differential contained in the Exchange's proposal is not an anomaly; it is symptom of a larger problem. As the Exchange acknowledges, its recent rate modifications have been driven by competitive pressures and its execution parameters are in-line with those of its competitors. In an effort to compete to attract volume, options exchanges continually escalate rebates offered to auction initiators and raise fees charged to auction responders. Many market observers believe the consequences of such fee structures that obviously favor initiators and heavily discriminate against responders are clear – options spreads have widened, price discovery has deteriorated, and the number of market makers have continued to decline.[9]

C. The Commission should undertake a broad review

The Commission asked in the Suspension Order whether it should undertake a broad review of the fee structures applied by the options exchanges to their price improvement auctions. On this question there seems to be unanimous agreement among commenters and industry observers that a holistic review is necessary. The Exchange's response correctly notes that the Commission's concerns about the CUBE Auction apply equally to other exchanges' auction mechanisms and the fees charged by those exchanges.[10] We agree with the Exchange and other commenters that the Commission should conduct a broad review of the fee structures applied by the options exchanges to their auction mechanisms.

The Commission also solicited feedback on revisions to auction rules. For its part, KCG believes a targeted modification to the options auction mechanism would significantly improve the market. ***Specifically, for Penny classes, if the displayed quantity is larger than the order size, an auction should not be permitted unless price improvement is guaranteed.*** Otherwise, the only thing an auction would accomplish in this circumstance is to facilitate a change in liquidity provider from a market maker publicly displaying a quote to an initiating participant. Over time, removing such trading opportunities discourages market makers from providing

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[9] *See* TABB Group Report, *Price Improvement Auctions: Segmenting Order Flow at the Expense of the Lit Market* (April 2016).

[10] *See* NYSE Response at 4.

narrow spreads with significant quantity and instead leads to wider quote widths and decreased size.

D. The Exchange's proposal is inconsistent with Exchange Act requirements as the fee structure is inequitable, unfairly discriminatory, and unduly burdens competition

The Exchange's proposed fee structure underscores how fees, rebates and credits are unevenly allocated among CUBE Auction participants. Simply put, the fee structure is designed to establish a material fee differential among auction participants of $0.83 in Penny classes and $1.18 in non-Penny classes to impair competition and favour initiators at the expense of responders.

The Commission's Suspension Order explicitly noted that it is considering disapproval based on legal concerns "as to whether the proposal is equitable and not unfairly discriminatory among Exchange members"[11] and "the potential burden on competition that its proposed fee changes would have on competition between Initiating Participants and non-Initiating Participants ..."[12] Despite these explicit warnings, the Exchange's comment letter in response to the Suspension Order was silent on these issues and did not address how the fee differential may or may not be consistent with applicable statutory requirements. Other observers filed comment letters on these issues and indicated their collective view that the proposal would violate statutory requirements applicable to a national securities exchange. Exchange Act.[13]

There seems to be no dispute that the fee differential 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

[11] Suspension Order at 8.

[12] Suspension Order at 9.

[13] *See* comment file https://www.sec.gov/comments/sr-nysemkt-2016-45/nysemkt201645.shtml

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 the consistency of views on this matter, the Commission should disapprove the proposal.

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KCG greatly appreciates the opportunity to comment on the Proposal and would be pleased to discuss these comments in greater detail. If you have any questions, please do not hesitate to contact John A. McCarthy (at [redacted] or [redacted]) or Tom Eidt (at [redacted] or [redacted]).

Sincerely,

/S/

John A. McCarthy
General Counsel