



July 28, 2016

**VIA E-MAIL**

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

Re: **NYSE Amex Options Fee Filing Rel. 34-78029 (SR-NYSEMKT 2016-45)**

Dear Mr. Fields:

CTC, L.L.C.<sup>1</sup> (“CTC”) appreciates the opportunity to comment in response to the Securities and Exchange Commission’s (“SEC’s”) recent order suspending NYSE MKT LLC’s (the “Exchange”) proposed rule change File No. SR-NYSEMKT-2016-45 (the “Rule Filing”) to modify the NYSE Amex Options Fee Schedule with respect to fees, rebates, and credits<sup>2</sup> relating to the Exchange’s price improvement auction mechanism (“CUBE Auction”) and instituting proceedings to approve or disapprove the Rule Filing. CTC commends the Commission for suspending the otherwise immediately effective Rule Filing as this change to the Exchange’s rules merits a full and public comment process. As explained herein, there are a number of elements in the Rule Filing (and similar rules on other options exchanges) that negatively impact liquidity in the options markets, thus raising costs on investors.

CTC’s primary concerns are that the CUBE Auction fees outlined in the Rule Filing: (1) disincentivize auction participation and price improvement by third-party options market makers and (2) create unfair economic incentives favoring auction order initiating firms. We believe this outcome is inconsistent with the statutory requirements of Sections 6(b)(4)<sup>3</sup>, 6(b)(5)<sup>4</sup> and 6(b)(8)<sup>5</sup> of the Securities Exchange Act of 1934 (the “Exchange Act”) and respectfully request that the Commission disapprove the Rule Filing. CTC further recommends that the SEC take action to comprehensively and promptly conduct a broad review of price improvement auction fee structures across all options exchanges.

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<sup>1</sup> CTC was established in January 1998. CTC’s business focus is trading in the capacity of an options market maker. CTC is currently a registered broker-dealer and a member firm at the Chicago Board Options Exchange, C2, NYSE Arca Options, NYSE Amex Options, the International Securities Exchange and NASDAQ OMX Phlx.

<sup>2</sup> The Exchange increased RFR Response fees for Non-Customers (including Market Makers) from \$0.12 to \$0.70 for Penny classes and from \$0.12 to \$1.05 for Non-Penny classes. The Exchange also increased the rebate for Initiating Participants from \$0.05 to \$0.18 for each of the first 5,000 Customer contracts executed in a CUBE Auction. The Rule Filing increased the break-up credit for each contract from \$0.05 per contract to \$0.35 for Penny classes and \$0.70 for Non-Penny classes.

<sup>3</sup> 78 U.S.C. 78(f)(b)(4)

<sup>4</sup> 78 U.S.C. 78(b)(5)

<sup>5</sup> 78 U.S.C. 78(b)(6)

## **Background**

In April 2010, the SEC proposed to adopt a \$0.30 cap on options exchange access fees (“Options Access Fee Proposal”).<sup>6</sup> The purpose of this proposal was to prohibit an exchange from imposing unfairly discriminatory terms that inhibit efficient access to quotations in listed options and to make options access fees comparable to those for NMS stocks. Another objective of the proposal was to provide fairer standards and more transparency on the maximum cost charged by exchanges for access to quoted prices. The Commission noted that “there are so many different fees across options exchanges, across different categories of options participants, and across different product types, that it is not easy to estimate the total cost of executing against a quotation for a particular transaction.”<sup>7</sup> While the Options Access Fee Proposal was never implemented, the proposal raised valid concerns about the ability of market participants to measure the total cost of a transaction, and more generally about access to liquidity in the options markets. The proposal also introduced the concept of applying market access fee caps in the options markets similar to those applied in the equities markets.<sup>8</sup>

Price improvement auction fee structures (including, but not limited to, those in the Rule Filing) are much like the access fees for equities under Regulation NMS<sup>9</sup> (“Reg NMS”) and discussed in the Options Access Fee Proposal. The Commission capped access fees for equities under Reg NMS<sup>10</sup> (and proposed similar caps in the Options Access Fee Proposal) to prevent the price distortion and unfair competition that occurs when exchanges continually raise fees to access displayed liquidity, and then use those access fees to subsidize increasingly higher rebates for other market participants. The SEC concluded that the Reg NMS caps were necessary to protect the markets in accordance with the Exchange Act<sup>11</sup>, and that exchanges did not have an incentive to adopt such caps without external intervention. We believe that the same logic applies here.

Both price improvement auction fees and access fees factor into the total cost of executing a particular transaction and ultimately influence market behavior. Prior to the Reg NMS caps, exchanges had wide latitude to continually impose increases in equity market access fees for liquidity takers. Similarly today, price improvement auction fees have increased for market maker auction responders<sup>12</sup> with commensurate increases in rebates for auction order initiators. Unchecked, this practice unfairly discriminates against options market makers who provide price improvement during auctions, creating an inappropriate burden on competition by favoring a subset of initiating participants—reducing their total transaction costs while increasing market maker total transaction costs.

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<sup>6</sup> <https://www.sec.gov/rules/proposed/2010/34-61902.pdf>

<sup>7</sup> Page 9 2010 Rule Proposal.

<sup>8</sup> We understand that appropriate SEC concerns regarding options exchange access fees over \$0.50 in penny-denominated options (i.e., half a tick) have resulted in the withdrawal of several options exchange fee proposals above this level. See, *inter alia*, <https://www.sec.gov/rules/sro/nysearca/2015/34-76439.pdf>

<sup>9</sup> 17 CFR 242.610

<sup>10</sup> 17 CFR §242.610

<sup>11</sup> See Section 11A(c)(1)(B) of the Exchange Act, 15 U.S.C. 789-1(c)(1)(B)

<sup>12</sup> In addition to the NYSE Amex Rule Filing, we note response fees on BOX of \$0.65/contract in penny classes (comprising a \$0.35 “Fee for Adding Liquidity” in PIP transactions plus a \$0.30 “Improvement Order” fee for market makers) and \$1.05/contract in non-penny classes (due to a higher \$0.75 “Fee for Adding Liquidity” plus the “Improvement Order” fee); see [http://boxexchange.com/assets/BOX\\_Fee\\_Schedule.pdf](http://boxexchange.com/assets/BOX_Fee_Schedule.pdf), dated November 2015. MIAx charges \$0.90/contract for all responders to “PRIME Auctions” in non-penny classes; see [https://www.miaxoptions.com/sites/default/files/MIAx\\_Options\\_Fee\\_Schedule\\_01012015C.pdf](https://www.miaxoptions.com/sites/default/files/MIAx_Options_Fee_Schedule_01012015C.pdf), dated January 1, 2015.

Through this process, we have seen a trend toward increasingly aggressive competitive cycles among options exchanges that attempt to out-do each other in bidding for order flow from auction initiators, evidenced by: (i) increased fees for options market maker auction responders and higher rebates for initiating participants; (ii) larger fee disparities between auction initiators and auction responders; (iii) allocation guarantees and “auto-match” mechanisms solely for auction initiators,<sup>13</sup> which allow initiators to have an automated “last look” at the final trading price (often improved by non-initiating market makers) markedly reducing incentives to provide the best possible opening auction price; and (iv) rules allowing auctions to start at the disseminated BBO or NBBO,<sup>14</sup> thereby permitting internalization by auction initiators at the expense of market makers who assumed risk by posting the best quotes in the displayed market.<sup>15</sup> We respectfully request that the Commission address these practices, which are unfairly discriminatory and impair liquidity in the options markets, by instituting caps on price improvement auction fees as it did with regard to access fees in equities markets as part of a comprehensive reassessment of options exchange auction market structure.

### **Auction Response Fees Should Be Capped at \$0.50 for All Series**

The SEC has expressed a preference that options exchange access fees not exceed \$0.50 in penny-denominated options (i.e., half a tick). We understand that this preference has resulted in the withdrawal of several options exchange fee proposals above this level, suggesting that without regulatory intervention, displayed quote access fees would have continued to increase.<sup>16</sup> Auction response fees are similar to displayed quote access fees, in that an order being auctioned is “displayed” for the duration of the auction, and market makers seeking to trade with the order compete to access this “displayed” order for the duration of the auction. Further, since most exchanges have rules that allow price improvement auctions to begin at a price equal to that of the NBBO, trading with an auctioned order would often be economically equivalent to trading with a displayed NBBO bid or offer, were it not for the significantly higher auction response fees that are charged in the absence of a regulatory cap on auction fees. As a result of these parallels, we respectfully propose that the SEC apply the same prudent and logical rationale underlying its decision to cap displayed quote access fees at \$0.50/contract in penny classes by similarly capping all price improvement auction response fees at the same level. (Because all price improvement auctions allow for price improvement in increments of 0.01, the \$0.50/contract maximum fee represents one-half of a pricing increment in all cases and should apply across all options classes.)

### **The Fee Differential Between Auction Initiators and Auction Responders Should Be Limited**

We understand that the Commission has historically deemed transaction fee differentials exceeding \$0.02/options contract for directed versus unaffiliated market makers trading against a directed order (also known as a “preferenced” order) to be inappropriate.<sup>17</sup> CTC agrees with the Commission’s

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<sup>13</sup> See e.g. NYSE MKT Rule 971.1NY(c)(1)(B)-(C)

<sup>14</sup> Although these auctions are referred to as “price improvement” auctions, auctions that commence at the BBO often do not result in price improvement.

<sup>15</sup> Example: Market Maker A is displaying the exchange’s best offer of 1.00, and Market Maker B is showing an offer of 1.05. An order flow provider affiliated with Market Maker B begins an action with a customer agency order paying 1.00, and its affiliate is willing to sell at that price in the auction (which represents less risk than continuously displaying a quoted offer at the same price). Market Maker A has a disincentive to further improve price to 0.99 due to high auction response fees. As a result, the auction completes at a price of 1.00. Market Maker B will receive a participation entitlement at 1.00, effectively taking priority at a price it was unwilling to quote in the displayed market.

<sup>16</sup> See, *inter alia*, <https://www.sec.gov/rules/sro/nysearca/2015/34-76439.pdf>

<sup>17</sup> See <https://www.sec.gov/rules/sro/phlx/2010/34-61547.pdf>

approach regarding transaction fee differentials, and respectfully proposes that the Commission impose a similar maximum fee differential of \$0.02 for the analogous case of solicited initiator vs. third-party responder interest in price improvement auctions.

Third-party auction responders serve a vital role in providing material price improvement. While precise public data on the details of price improvement auction volume is difficult to obtain, according to BOX data released pursuant to a filing to extend an auction pilot program,<sup>18</sup> in July 2013 (the latest period available) *more than half* of all total price improvement dollars were provided by “Other” (i.e., non-initiator, non-directed) auction responders. Therefore, any fee differential that adversely impacts the ability of these third party auction responders to provide price improvement will have a material impact on total price improvement for investors and raises clear investor protection concerns. While any discriminatory pricing that favors firms controlling order flow over other displayed liquidity providers raises concerns, we believe that limiting this fee differential to a level such as \$0.02 provides for a less damaging allocation of fees among participants, protects investors by reducing impediments to price improvement and limiting price distortion, and enhances the competitive landscape for this important options market feature.

**Break-Up Credits, Which Offer Incentives Not to Trade, Should Be Viewed as Presumptively Inconsistent with the Exchange Act**

Price improvement auction initiators and responders are directly competing to interact with the order being auctioned. “Break-up credits,” which are rebates paid to auction initiators only when they do *not* participate in a transaction, are unfairly discriminatory in that only initiating participants are eligible to receive them. No other auction participant is ever eligible to receive a rebate in exchange for *not* trading in an auction. This incentivizes auction initiators not to trade in certain auctions as a means of revenue generation, and inappropriately provides compensation when no service is provided to investors or the market. Break-up credits represent an inequitable allocation of fees, resulting in unfair discrimination between market participants. As such, break-up credits should be deemed presumptively inconsistent with the Act.

Further, in cases where the initiator’s market making affiliate is not interested in trading with a given price improvement auction order or expects that the profit from internalizing the trade would be smaller than the break-up credit, the availability of a break-up credit could create a perverse incentive for the initiating participant to begin the auction at a price that is less attractive for the agency order in hopes that a third-party participant will then be more likely to step in and execute the order, resulting in payment of the break-up credit to the initiating participant.<sup>19</sup> Ultimately, this could result in higher prices for the customer, significantly reduced incentives for unaffiliated market maker participation, and unfair advantages to auction initiators contrary to investor protection and the public interest.

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<sup>18</sup> <https://www.sec.gov/rules/sro/box/2013/34-70369-ex3.pdf>

<sup>19</sup> Example: A non-penny option is offered at \$1.05 in the displayed market. An order routing firm has a customer order to buy the option. The order routing firm’s market maker affiliate values the option at slightly below \$1.03. Due to a large break-up credit, instead of beginning the auction at \$1.03, the initiating market maker may advise the order router it is willing to begin the auction at the inferior (for the customer) price of \$1.04, inviting third-party sellers to undercut the original offer so that the initiating market maker can be replaced on the trade, thereby receiving the \$0.70 break-up credit (the current Exchange credit in the Rule Filing) – representing a profit greater than the small edge available from selling at \$1.03.

Mr. Brent J. Fields

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For the reasons cited above, we respectfully request that the Commission disapprove the referenced Rule Filing. Further, we note that the issues referenced here have a much broader impact than a single options exchange and respectfully propose that the Commission expand its review beyond the Rule Filing by simultaneously taking action to comprehensively and promptly conduct a broad review of auction fee structures across all options exchanges, immediately disallowing similar price improvement auction fees and incentives wherever they exist. We believe that these steps will allow the Commission to prevent unfair discrimination, protect investors and the public interest, and preserve an equitable competitive landscape in conformance with the Exchange Act.

Should you have any questions with respect to this letter, we welcome you to contact us. We appreciate the opportunity to respond.

Sincerely,

A handwritten signature in black ink, appearing to read "Eric Chern", written in a cursive style.

Eric Chern

Chief Executive Officer, CTC Trading Group, L.L.C., sole Manager of CTC, L.L.C.

cc: The Honorable Mary Jo White, Chair  
The Honorable Michael S. Piwowar, Commissioner  
The Honorable Kara M. Stein, Commissioner  
Mr. Stephen Luparello, Director, Division of Trading and Markets  
Mr. Gary Goldsholle, Deputy Director, Division of Trading and Markets  
Mr. David S. Shillman, Associate Director, Division of Trading and Markets