CITADEL

May 9, 2012

By Electronic Mail

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: *Proposed Rule Change to Amend the BATS Fee Schedule; File No. SR-BATS-2012-015*

Dear Ms. Murphy:

Citadel LLC ("**Citadel**")[1] appreciates the opportunity to submit this comment letter in response to the BATS Exchange, Inc. ("**BATS**") rule filing referenced above (the "**Rule Filing**").[2] The Rule Filing, among other things, charges excessive fees to access BATS non-penny pilot class quotes ("**take fees**") and correspondingly increases certain rebates that BATS pays for adding liquidity on BATS. For reasons described in further detail below, Citadel respectfully requests that the U.S. Securities and Exchange Commission ("**Commission**") suspend the operation of the Rule Filing and disapprove it because it imposes unreasonable market access fees, impedes price transparency and unduly burdens competition among options markets, and thereby is generally inconsistent with the statutory requirements set forth in sections 6(b)(4), 6(b)(5) and 6(b)(8) of the Securities Exchange Act of 1934 (the "**Exchange Act**").

I. The Rule Filing Applies an Excessive Take Fee to Non-Penny Pilot Classes

The Rule Filing increases the take fees and rebates applicable to options orders. For penny pilot classes, the increase is relatively small – generally between zero and \$.08. For non-penny pilot classes, the fee and rebate increases are quite substantial, particularly for orders placed by Professionals, Firms and Market Markers.[3] Specifically, for orders in non-penny pilot

[1] On an average day, Citadel accounts for well over 10 percent of U.S. listed equity volume and well over 20 percent of U.S. listed equity option volume. Founded in 1990, the Citadel group of companies includes an asset management division that principally executes alternative investment strategies across multiple asset classes, and Citadel Securities, which includes an industry leading market making franchise and an institutional markets platform. Citadel operates in the world's major financial centers, including Chicago, New York, London, Hong Kong and San Francisco.

[2] Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Fees for Use of BATS Exchange, Inc., Exchange Act Release No. 66794 (Apr. 12, 2012), 77 FR 23307 (Apr. 18, 2012).

[3] The term "Professional" is defined in BATS Rule 16.1 and generally includes non-broker-dealer members who place on average over 390 orders in listed options per day for their own beneficial accounts. The terms "Firm" and "Market Maker" are defined in the BATS Fee Schedule and generally apply to transactions identified by the

131 South Dearborn Street
Chicago, Illinois 60603

classes placed by Professionals, Firms and Market Markers, the Rule Filing nearly doubles the take fee, from $.44 to $.80 per contract, and more than doubles the possible rebate, from $.22 to $.70 per contract. For Public Customer orders, the Rule Filing increases the take fee and rebate to $.75.

The amended BATS take fees for non-penny pilot classes are excessive and distortive. The $.75-.80 take fee imposed by BATS under the new fee schedule far exceeds the typical take fee charged by competing options exchanges. Other options markets generally charge a maximum take fee of around $.40 or $.50 in non-penny pilot classes.[4] The $.75-.80 Take fee is also nearly triple the access fee cap of $.30 proposed by the Commission in 2010 ("**Fee Cap Proposal**").[5]

II. The Excessive BATS Take Fee Distorts the True Prices of Options

As noted in our 2008 petition for rulemaking to impose a cap on take fees ("**2008 Petition**"), high take fees distort the true price of an option, thereby undermining the price transparency that that is central to fair and efficient markets.[6] Fees imposed by exchanges are not reflected in displayed option quotations. This causes the final cost of an option, inclusive of

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member for clearing in the "Firm" or "Market-Maker" range at the Options Clearing Corporation. The BATS Fee Schedule is available at http://batstrading.com/resources/regulation/rule_book/BZX_Fee_Schedule.pdf.

[4] *See, e.g.*, NYSE Arca Options Fees Schedule, *available at* http://globalderivatives.nyx.com/sites/globalderivatives.nyx.com/files/nysearcaoptionsfeeschedule_02012012.pdf; NYSE Amex Options Fee Schedule, *available at* http://globalderivatives.nyx.com/sites/globalderivatives.nyx.com/files/nyse_amex_options_fee_schedule_05_01_12.pdf; International Securities Exchange Schedule of Fees, *available at* http://www.ise.com/assets/documents/OptionsExchange/legal/fee/fee_schedule.pdf; Chicago Board Options Exchange, Inc. Fee Schedule, *available at* http://www.cboe.com/publish/feeschedule/CBOEFeeSchedule.pdf; C2 Options Exchange, Inc. Fee Schedule, *available at* http://www.c2exchange.com/publish/C2FeeSchedule/C2FeeSchedule.pdf; NASDAQ OMX PHLX LLC Pricing Schedule, *available at* http://nasdaqomxtrader.com/content/marketregulation/membership/phlx/feesched.pdf; NASDAQ Options Market Fees, *available at* http://www.nasdaqtrader.com/content/ProductsServices/PriceList/nasdaq_options_pricing.pdf. While some exchanges charge a non-penny pilot payment for order flow fee of $.65-$.70 per contract, this fee only applies when a non public customer sends an order executes that against a public customer order. As a result, the average payment for order flow fee for a non-public customer is much lower than these headline numbers because an order sender expects to pay this fee only some of the time (roughly half of the time in our experience).

[5] Proposed Amendments to Rule 610 of Regulation NMS, Exchange Act Release No. 61902 (Apr. 14, 2010), 75 FR 20738 (Apr. 20, 2010) ("**Fee Cap Proposal**").

[6] Letter from John C. Nagel, Managing Director & Deputy General Counsel, Citadel, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated July 15, 2008 ("**2008 Petition**"), *available at* http://www.sec.gov/rules/petitions/2008/petn4-562.pdf.

fees, to differ from the quoted price. As the cost of the take fee increases, so does the distortion between the quoted price of the option and the final price. Thus, the take fee of $.75-.80 proposed by BATS will result in a final price for an option executed on BATS that is materially different than its published quotation.

The Commission agreed that excessive take fees have a distortive effect on options prices in the Commission's Fee Cap Proposal, stating that for displayed options quotations to be "fair and useful," the extent of the potential disparity between the displayed price and the true price for accessing an option quotation must be limited.[7] In the Fee Cap Proposal, the Commission proposed prohibiting take fees in excess of $.30 because large take fees could have a distorting impact on the market and hinder the ability of market participants to compare quotations among different options exchanges.[8] If the Commission deems a take fee in excess of $.30 to have a distortional impact on options prices, a take fee of $.75-.80, nearly three times that amount, should be deemed to have a far greater distortive impact.

The potential for price distortion is compounded by the rules governing trade-throughs and best execution. All options exchanges have procedures that require orders to be routed to the market with the national best bid or offer ("**NBBO**"). As a result, an excessive take fee cannot be avoided in situations where the exchange charging such a fee is the exchange with the NBBO. Instead, due to these regulatory requirements, broker-dealers (and indirectly their customers) are effectively required to pay the take fee, no matter how high, in order to fulfill their trade-through and best execution obligations.

Market participants rely on the usefulness and accuracy of displayed quotations to comply with the prohibition against trade-throughs and the obligation to seek best execution for customer orders. The excessive take fee BATS imposes on non-penny classes and the wide disparity between it and the typical take fees charged by competing options exchanges materially distorts the transparency of the prices seen by market participants, because these fees are not reflected in the displayed quotations. This distortion makes it difficult for market participants to meaningfully compare quotations in non-penny classes across options markets.

In light of the Rule Filing, a published quotation on BATS is not a reliable indication of the true cost of trading that option on BATS, and this may hinder the ability of broker-dealers to provide best execution to their customer orders and for customers to assess the quality of their option executions. Additionally, the disconnect between the quoted price and the actual price can leave a customer worse off, and paying more, for having been routed, due to the trade-through and best execution rules, to BATS, as the options market that displayed the lowest price

[7] Fee Cap Proposal, 75 FR at 20744.

[8] *Id.*

but charged the highest take fee. Finally, the wide discrepancy between the take fees charged by BATS and competing options exchanges can cause what appears in the consolidated data feed to be identical quotations to in fact represent quite different true prices, once each option exchange's take fee is factored in. Thus, and as noted by the Commission in the Fee Cap Proposal,[9] the imposition of substantial take fees by options exchanges, as BATS does in its Rule Filing, may counteract the benefits of inter-market price protection.

III. The Excessive BATS Take Fee Hinders Market Liquidity

In the Rule Filing, BATS justifies its high take fees by pointing out that the corresponding rebate is greater than the rebate offered by other options markets. BATS asserts that this will incentivize liquidity providers to post aggressive quotations on BATS, which BATS claims will result in better execution prices on BATS.

Although the Rule Filing may encourage increased liquidity on BATS in the short term, it will decrease liquidity on other options exchanges and encourage fee arbitrage. The wide differential between the BATS rebate and competing exchange rebates will compel market participants to post quotations in non-penny classes on BATS rather than competing exchanges to collect the large rebate. Absent the large rebate, many of these quotes would have otherwise been posted at the same price on a different options exchange that charges a lower take fee. As more liquidity providers seek the exorbitant rebate offered by BATS, fewer liquidity providers will be interested in posting their quotations on competing exchanges, where the potential rebate is much lower. Market participants in turn, will be obligated to seek liquidity on BATS when the best prices migrate to BATS, thus forcing market participants to pay the corresponding high take fee charged by BATS.[10] As discussed above, the rules governing trade-throughs and best execution, and requiring orders to be routed to the market with the NBBO, constrain the liquidity seeker's choice of executing market.

Finally, to preserve their market share, other exchanges will be compelled to respond with similarly high rebates and take fees in non-penny pilot classes. The end result of this race to the bottom will be no increase in quoted liquidity, but simply a higher take fee and a higher rebate across exchanges.

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[9] *Id.* at 20743.

[10] The financial burden of the high BATS take fee is further compounded by the routing fee charged if another exchange sends an order to BATS. That combination may, in some cases, result in a total fee in excess of $1.00 being imposed on the market participant whose order is routed to BATS from another exchange.

IV. The Excessive BATS Take Fee is Anti-Competitive

As the Commission recognized in its Fee Cap Proposal, market forces are not always sufficient to prevent unfair pricing structures for accessing the market.[11] Certain regulatory limits, such as rules that prohibit trade-throughs, impair the ability of competitive forces to constrain take fees in the options markets. As discussed in our 2008 Petition, high take fees like the $.80 fee proposed in the Rule Filing are sustainable predominantly because these regulatory obligations require options orders to be executed on the exchange with the NBBO, regardless of the size of any additional fees.[12] If BATS alone is quoting at the NBBO, the rules prohibiting trade-throughs force market participants to send their orders to BATS and pay the excessive take fee. Additionally, market participants who only take liquidity from BATS are further penalized compared to those who offer liquidity and thus may be able to recover a majority of the fee via the corresponding rebates BATS pays for providing orders.[13] If a market participant does not act as a liquidity provider on BATS, and yet is forced to route to BATS due to regulatory requirements, the impact of the high take fee imposed on the market participant cannot be counteracted by the possibility of a similarly high rebate.

The rules that require broker-dealers to send their orders to the markets displaying the best quotations, while also requiring them to ignore the fees associated with obtaining access to those quotations, allows – and even encourages – markets to charge excessive take fees. With no options exchange fee cap currently in place, options exchanges have an incentive to charge higher fees to fund higher rebates. If the Rule Filing is not suspended, other exchanges will respond with higher take fees and rebates, in order to stay competitive and maintain liquidity on their own markets. If left unabated, a domino effect of exchanges taking increasingly improper advantage of the trade-through rule and raising take fees to even more outrageous levels will result.

V. Conclusion

For the foregoing reasons, Citadel respectfully requests that the Commission suspend the operation of the Rule Filing and disapprove it as inconsistent with the statutory requirements set forth in sections 6(b)(4), 6(b)(5) and 6(b)(8) of the Exchange Act. Given the large size of the current fee increase and the potential consequences unaddressed by BATS in its Rule Filing, the Commission should require BATS to subject its rule change proposal to full notice and comment.

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[11] *Id.* at 20742 – 20743.

[12] 2008 Petition, p. 3.

[13] We note that the majority of retail orders are liquidity taking and thus the Rule Filing disproportionately impacts retail orders.

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Regardless of whether the Commission ultimately agrees with our analysis, Citadel respectfully submits that the Commission must recognize that this Rule Filing is not a mere "uncontroversial" fee filing. Rather, it represents a significant change in options market structure that should be subject to robust public comment and full Commission review.

If you have any questions, please do not hesitate to contact me at (312) 395-2100.

Sincerely,

John C. Nagel
Managing Director and General Counsel
Citadel Securities

cc: Hon. Mary L. Schapiro, Chairman
Hon. Luis A. Aguilar, Commissioner
Hon. Daniel M. Gallagher, Commissioner
Hon. Troy A. Paredes, Commissioner
Hon. Elisse B. Walter, Commissioner
Robert W. Cook, Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets