Elizabeth King
General Counsel
and Corporate
Secretary

New York Stock Exchange
11 Wall Street
New York, NY 10005
T+[redacted]
F+[redacted]

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Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F. Street N.E.
Washington, D.C. 205549-0609

RE: Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove 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

Dear Mr. Fields,

NYSE MKT LLC, on behalf of NYSE Amex Options (the "Exchange"), submits this comment letter in response to the above-referenced Order,[1] which suspended the Exchange's proposal (in NYSEMKT-2016-45) to, among other things, modify fees and credits relating to the Exchange's Customer Best Execution ("CUBE") Auction (the "Filing"). The Exchange thanks the Commission for the opportunity to comment on the Order to clarify the context surrounding the adoption of the CUBE Auction, and related fees and credits, as well as on price improvement auctions generally. As discussed herein, the Exchange believes that any review by the Commission of price improvement auctions should take a holistic view of such auctions and not focus solely on the fees of one exchange.

Background leading up to adoption of CUBE

The Exchange has previously expressed concern about options markets' electronic auction mechanisms ("Mechanisms") because of its view that Mechanisms discourage displayed liquidity and impair price discovery. In particular, when these Mechanisms were initially proposed by a competitor, the Exchange raised concerns about anti-competitive order routing practices, including internalization, which could result from this new functionality.[2] At that time,

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[1] See Securities and Exchange Release No. 78029 (June 9, 2016), 81 FR 39089 (June 15, 2016) (SR-NYSEMKT-2016-45) ("Order").

[2] See, e.g., Letters from Michael J. Ryan, Executive Vice President & General Counsel, Exchange, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated February 14, 2003 ("MKT Feb. 14th Letter") and September 12, 2003 ("MKT Sept. 12th Letter"),

the Exchange explained that, by facilitating internalization, Mechanisms "undermine[] both national market system goals and a broker's best execution obligations" and potentially "lead[] to the deterioration of quoted markets on exchanges as exchange market makers widen their quotes in the expectation that only difficult orders will be routed to them."[3] The Exchange likewise expressed concern that the unlit ("flashed") nature of auction interest would limit opportunity for real and robust competition.[4]

The Commission, however, approved exchange proposed Mechanisms. The earliest iterations of Mechanisms approved by the Commission required that each paired order be submitted only at a price that improved the National Best Bid and Offer ("NBBO"). In other words, such orders were *guaranteed* price improvement. Subsequently, the Commission approved Mechanisms that eliminated guaranteed price improvement and instead only required an *opportunity* for price improvement. In doing so, the Commission approved the submission of orders for auction that were priced equal to the NBBO, on grounds that such orders would be guaranteed an execution price of at least the NBBO and still have an opportunity for a price better than the NBBO.[5]

The Exchange believes that Mechanisms should *guarantee* price improvement. In the absence of such a guarantee, Mechanisms operate as de facto NBBO internalization Mechanisms for order-submitting firms. The Exchange believes that the implementation of Mechanisms that do not require price improvement has contributed to the increasing erosion of liquidity at the NBBO. Such Mechanisms allow firms to use market maker quotes as reference prices at which they can internalize, without the firms themselves displaying public quotes. As a result, there are fewer trading opportunities for market makers who do display their quotes, which can ultimately lead to wider quote widths with decreased size.

After more than a decade of eschewing Mechanisms, to remain competitive with its peers, the Exchange adopted the CUBE Auction in 2014.[6] The Exchange adopted execution parameters in line with those of competing exchanges for CUBE Orders of greater than 50 contracts, but is

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available here, https://www.sec.gov/rules/sro/bse/bse200552/bse200552-8.pdf (attached as Exhibits A and B).

[3] See id., MKT Feb. 14th Letter at 6-7 and note 12 (citing previous statements by the Exchange in opposition to internalization); see also id., MKT Sept. 12th Letter at 2-3.

[4] See supra note 2, MKT Feb. 14th Letter at 7-8.

[5] See, e.g., Securities Exchange Act Release Nos. 57847 (May 21, 2008), 73 FR 30987 (May 29, 2008) (SR-ISE-2008-29) ("ISE Approval Order"); 59654 (March 30, 2009), 74 FR 15551 (April 6, 2009) (SR-BX-2009-008).

[6] The CUBE Auction is a mechanism in which an Exchange ATP Holder submits an agency order on behalf of a customer for price improvement, paired with a contra-side order ("Contra Order") guaranteeing execution of the agency order ("CUBE Order") at or better than the National Best Bid or Offer ("NBBO") depending on the circumstances. The Contra Order could be for the account of the ATP Holder that initiated the CUBE Auction ("Initiating Participant"), or an order solicited from another participant. The agency order is exposed for a random period of time between 500 and 750 milliseconds in which other ATP Holders submit competing interest at the same price as the initial price or better ("RFR Responses"). The Initiating Participant is guaranteed at least 40% of any remainder of the order (after public customers and better-priced RFR Responses) at the final price for the CUBE order. See NYSE MKT Rule 971.1NY.

one of only two options exchanges that requires price improvement of at least $0.01 over the exchange BBO for CUBE Orders of 50 or fewer contracts.[7]

In connection with the CUBE Auction, the Exchange adopted fees and credits comparable to the fees for Mechanisms charged by its competitors, including BOX Options Exchange, LLC ("BOX"), the Chicago Board of Options Exchange ("CBOE") and International Securities Exchange, LLC ("ISE").[8] Consistent with the pricing structure for Mechanisms utilized on other exchanges, the Exchange implemented fees applicable to members submitting the following orders to a CUBE Auction: (i) the agency order (or CUBE Order); (ii) the order guaranteeing the execution of the CUBE Order (or Contra Order); and (iii) the RFR Response (i.e., orders and quotes submitted during a CUBE Auction that are executed against the agency order).[9] Specifically, the Exchange established a $0.20 per contract fee for each (non-Customer) CUBE Order; a $0.05 per contract fee for each (non-Customer) Contra Order executed in the CUBE Auction; and a $0.55 and $0.90 per contract fee for RFR Responses for Penny Pilot and non-Penny Pilot issues, respectively.[10] In addition, consistent with its competitors, the Exchange offered a per contract rebate (or break-up credit) of $0.40 and $0.80 per contract for Penny Pilot and non-Penny Pilot issues, respectively to Initiating Participants for each contract in the Contra Order that does not trade with the agency (CUBE) order.[11] The Exchange noted in the CUBE Fee Filing that

> the proposed pricing for the CUBE Auction is comparable to that of other exchanges offering similar electronic crossing mechanisms, and the Exchange believes that, based on experience with electronic price improvement crossing mechanisms on other markets, market participants understand that the price-improving benefits offered by the Auction justify and offset the transaction costs associated with the Auction.[12]

Over the past two years, to remain competitive, the Exchange has modified the rates charged for participation in the CUBE Auction. As of January 2016, the Exchange charged RFR Response fees for Non-Customers of $0.60 and $0.90 per contract in Penny Pilot and non-Penny Pilot issues, respectively; and issued Initiating Participant credits of $0.35 and $0.70 per contract in Penny Pilot and non-Penny Pilot issues, respectively (the "January CUBE rates").[13]

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[7] See Rule 971.1NY(b)(1)(A) and (1)(B). CBOE is the only other exchange that requires price improvement for orders of 50 contracts or fewer.

[8] See Securities and Exchange Release No. 72469 (June 25, 2014), 79 FR 37380, at 37381-83 (July 1, 2014) (SR-NYSEMKT-2014-52) ("CUBE Fee Filing") (immediately effective filing adopting CUBE fees and credits and discussion of how Exchange fee structure and pricing is consistent with that of BOX, ISE and CBOE).

[9] The Exchange notes that, consistent with other exchanges, CUBE Orders and RFR Responses for the account of a Customer are not charged a fee. Further, the Exchange issued guidance advising ATP Holders that Contra Orders for the account of a Customer could not be entered into a CUBE Auction. See id., 79 FR at 37380, note 10.

[10] See CUBE Fee Filing, supra note 8, 79 FR at 37380.

[11] See id., 79 FR at 37381.

[12] See id., 79 FR at 37382.

[13] See Securities Exchange Act Release No. 77106 (February 10, 2016), 81 FR 8107 (February 17, 2016) (SR-NYSEMKT-2016-18).

In February 2016, the Exchange filed to amend the January CUBE rates, explicitly stating that the changes were "designed to address concerns expressed to the Exchange by Market Makers about imposing oversized transaction fees on market makers (MMs) when they compete with the facilitation side to pre-matched auction crosses, including the CUBE Auction."[14] In its filing, the Exchange also acknowledged that the market makers believed the so-called break-up credit was "designed to hamper traders (primarily MMs) from competing on auction crosses."[15] To address these concerns, the Exchange reduced its RFR Response fees for Non-Customers to $0.12 per contract for all issues; and reduced the Initiating Participant credit to $0.05 per contract for all issues (the "February CUBE rates").[16] Two months after implementing the February CUBE rates, the Exchange submitted the Filing, which sought to restore its CUBE fees and credits to levels substantially similar to its January CUBE rates.

Impact of the Order on the Exchange

Per the Order, the Commission temporarily suspended the fees proposed in the Filing and instituted proceedings to determine whether to approve or disapprove the Filing based on its concern about the potential effect the CUBE fees "may have on the operation of the CUBE Auction and its potential to provide price improvement to customers, as well as on competition among participants initiating CUBE Auctions and those responding to them."[17] Of specific concern to the Commission is that for Penny Pilot issues "the fee differential between Non-Customer auction responders and Initiating Participants can be $0.83 per executed contract" and that "the fee charged Non-Customer auction responders would exceed one-half the minimum trading increment."[18]

While the Exchange shares the Commission's concerns, the Exchange does not believe that these concerns are confined solely to the Exchange's pricing of its CUBE Auction and that it is, therefore, inappropriate and ineffective to suspend the Exchange's proposed fees. The Order identifies concerns about the Exchange's CUBE Auction that apply equally to other exchanges' Mechanisms and the fees charged by those exchanges. In particular, the Exchange is aware of two other options exchanges that currently charge auction response fees in Penny Pilot issues of more than $0.50 per contract.[19] By solely suspending the fees proposed in the Filing, the Commission does not address the market structure concerns it raises as market participants simply can trade using other exchanges' Mechanisms. The Commission has, however, placed the Exchange at a competitive disadvantage to these exchanges as their pricing was unaffected by the Order. The Order was met with a swift and steep decline in the initiation of CUBE Auctions. A comparison of the volume of initiating CUBE Orders on the days immediately before the Order against the days immediately after revealed an 88% decrease in the volume of

[14] See id, 81 FR at 8108 (internal citations omitted).

[15] Id.

[16] See id., 81 FR at 8107.

[17] See Order, supra note 1, 81 FR at 39090.

[18] See id., 81 FR at 39091.

[19] See, e.g., BOX fee schedule, available here, http://boxexchange.com/assets/BOX_Fee_Schedule.pdf (charging total response fee of $0.65 to market makers and $0.72 to all other participants); PHLX fee schedule, available here, http://www.nasdaqtrader.com/Micro.aspx?id=phlxpricing (charging a total response fee of $0.55 to market makers and $0.48 for all other participants).

initiating CUBE Orders. While the Exchange lacks insight into the volume of orders initiated on other exchanges' Mechanisms, we assume this order flow was simply diverted to exchanges not subject to the Order by firms that continue to find Mechanisms valuable.

Moreover, the Order only obliquely references that the rates suspended by the Order are substantially similar to the January CUBE rates.[20] The Order likewise does not acknowledge that, as discussed above, the Exchange modified its January CUBE rates to attempt to address the very concerns raised by the Order (i.e., the impact lowered response fees may have on Mechanisms).[21] Unfortunately, the February CUBE rates, which were meant to "provide the concerned market makers a platform on which they can provide proof of concept," while philosophically sound, proved commercially untenable.[22] Specifically, after implementing the February CUBE rates, the Exchange saw a 25% decrease in the initiation of CUBE Auctions (in February) as compared to the three-month average CUBE volume for November 2015- January 2016. Given the number of competing Mechanisms on exchanges that did not similarly alter their pricing, the Exchange believes firms seeking to maximize internalization opportunities may have directed volumes to other venues where this goal could be more easily accomplished.[23] Thus, the Exchange was unable to compete for the majority of Mechanism-eligible orders and submitted the Filing to return to pricing substantially similar to the January CUBE rates and the rates offered on competing exchanges.[24] The Commission's suspension of the Filing, while leaving the similar Mechanisms and fees of other exchanges unchanged does nothing to address the market structure concerns raised by the Commission and only serves to penalize the Exchange.

Exchange Comments on Mechanisms

The Commission seeks comments on "[w]hether the Commission should undertake a broader review of the fee structures applied by the options exchanges to their price improvement auctions."[25] The Exchange believes that the Commission should undertake a broad review and that any change the Commission determines to take as a result of that review should be applied to all exchanges. The ad hoc suspension of the Exchange's proposed fees in the Filing was done without any such review and was applied solely to the fees of one exchange. The Exchange strongly urges the Commission to end its temporary suspension of the Exchange's Filing while it undertakes this review. The only impact of the Order is to put the Exchange at a disadvantage to its competitors whose comparable fees were unaffected. The market structure concerns that the Commission raises in the Order persist, as other exchanges continue unabated in offering rates for Mechanisms comparable to those suspended in the Filing.

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[20] See Order, supra note 1.

[21] See supra note 13.

[22] Id., 81 FR 8108.

[23] CUBE is one of only two Mechanisms that still requires price improvement over the Exchange's Best Bid and Offer, which is another factor that makes the Exchange's CUBE a less desirable Mechanism for would-be internalizers than exchanges that do not require such improvement. See supra note 7.

[24] The Exchange notes that initiating CUBE volume more than doubled in April following the Filing.

[25] See Order, supra note 1, 81 FR at 39091.

The Exchange believes that the Commission should also reconsider the application of Mechanisms. Specifically, if the fundamental point of a Mechanism is to deliver price improvement, then these Mechanisms should *require* price improvement – rather than permit orders to be internalized at the NBBO. The Exchange believes the Commission should evaluate the impact on market quality if market participants are able to bypass a market maker's quote and trade at the same price (i.e., the NBBO)

In closing, the Exchange strongly urges the Commission to undertake a broader review of the functioning of Mechanisms, and the fee structures applied thereto, on all options exchanges with an emphasis on the market as a whole. The Exchange has a strong interest in seeing options market volumes grow and firmly believes that lit, transparent, easily accessible quotes are among the best means for fostering that growth. There must be incentives for market participants to display transparent prices, however. Especially in a quote-driven marketplace such as options, it is necessary to reward those who accept quoting obligations and risks with the opportunity to trade with all types of order flow. Until the Commission completes its review of the Mechanisms and related fees, however, it should permit exchanges to compete under the same regulatory standards.

We thank the Commission again for the opportunity to comment on the Order. If you have any additional questions, or if we can be of further assistance in this matter, please do not hesitate to contact us.

Very truly yours,

Elizabeth K. King