optiver

August 3, 2016

Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: *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; File No. SR-NYSE MKT-2016-45*

Dear Mr. Fields:

Optiver US LLC ("Optiver US") respectfully submits this letter in response to the Securities and Exchange Commission (the "Commission" or "SEC") Order Instituting Proceedings to determine whether to approve or disapprove the above referenced NYSE MKT LLC (the "Exchange") proposed rule change to modify the NYSE Amex options fee schedule.[1]

Optiver is a global proprietary trading firm.[2] We do not have customers, nor do we carry any customer funds. As a proprietary trading firm, we trade on over 50 exchanges in equities, futures, and options markets worldwide. Across all markets, Optiver supports regulatory policies that promote transparency, open access to markets, and fair competition amongst all market participants.

Optiver US is an SEC-registered broker-dealer and a registered Market Maker on ten US options exchanges. As one of the leading liquidity providers in major index ETF option classes, Optiver US supports the Commission's decision to temporarily suspend and review the Proposal and appreciates the opportunity to comment on the same. Specifically, and as discussed in more detail below, Optiver US believes the inequitable allocation of fees among Exchange members set forth in the Proposal is unfairly discriminatory and imposes an unreasonable burden on competition. Optiver US also believes that the discriminatory fee issue is not confined to the Exchange and the single Proposal, but rather, is an industry-wide problem that requires immediate attention. As a result, Optiver US urges the Commission to expand its review of exchange fee structures to include all exchanges offering price improvement auctions with discriminatory fees.

---

[1] 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. 34-78029 (June 9, 2016), 81 FR 39089 (June 15, 2016); Notice of Filing and Immediate Effectiveness of Proposed Rule Change Modifying the NYSE Amex Options Fee Schedule, Exchange Act Release No. 34-77658 (Apr. 20, 2016), 81 FR 24674 (Apr. 26, 2016) (the "Proposal").

[2] Established in 1986, Optiver has offices in Amsterdam (Optiver Europe), Chicago (Optiver US LLC), and Sydney (Optiver Asia Pacific). With over 900 employees, Optiver trades on over 50 exchanges on four continents.

A. The Proposed Fee Structure is Unfairly Discriminatory among Market Participants.

In its Proposal, the Exchange asserts that the proposed modifications to the Customer Best Execution Auction ("CUBE Auction") fees are "reasonable, equitable and non-discriminatory because they apply *equally* to all ATP Holders that choose to participate in the CUBE" (emphasis added).[3] However, a review of the Exchange's CUBE Auction fee schedule reveals that the fees are in fact inequitably allocated based on participant type. Specifically, Non-Customer Auction Responders are charged $0.70 per contract in Penny classes, while Initiating Participants are charged $0.05 per contract in Penny classes, resulting in a $0.65 fee differential.[4] This fee differential is further exacerbated by Exchange fee rebates offered *solely* to the largest Initiating Participants, resulting in a potential fee differential of $0.83 per contract in Penny classes.[5] This gross disparity in fees is unreasonable and unfairly discriminatory towards a specific type of market participant (*i.e.*, Responders) to the benefit of another (*i.e.*, Initiating Participants) in violation of Sections 6(b)(4) and 6(b)(5) of the Securities Exchange Act of 1934.[6]

B. The Discriminatory Fee Structure Imposes an Unreasonable Burden on Competition and Hinders Price Improvement.

The discriminatory Exchange fees severely impair a Responder's ability to offer price improvement in the CUBE Auction. In fact, as explained in more detail below, application of the $0.83 Exchange fee disparity stymies a Responder's ability to offer price improvement over an Initiator by 83%, all else being equal between the two participants. By preventing Responders from participating, the discriminatory Exchange fees impose an unreasonable burden on competition and enable the CUBE Auction to operate as a de facto internalization mechanism.

In a free and open market, option Market Makers and other liquidity providers (collectively, "Market Participants") compete with each other for customer orders. With respect to pricing options, Market Participants assume an option's theoretical value and attempt to place bids below that value and offers above that value, given an assumed level of risk tolerance (*i.e.*, the "Spread"). Once established, the Spread is subsequently adjusted to account for applicable exchange fees and rebates. In short, adding applicable fees will widen a Market Participant's Spread and subtracting applicable rebates will tighten a Market Participant's Spread. Thus – in the absence of discriminatory fees – Market Participants are compelled to compete for orders by calculating the most accurate theoretical values and offering the tightest Spreads. Conversely, when discriminatory fees unfairly skew competitive edge in favor of one Market Participant over another, *as is the case with the Exchange's proposed fees*, true price competition in general ceases to exist, resulting in a high rate of internalized orders.

To further elaborate, Market Participants calculate theoretical values and assumed Spreads on a very granular level. In fact, Market Participants often calculate theoretical values and Spreads to the 1/100 of

---

[3] Proposal at 24675.

[4] Notably, the Proposal and prior proposals have increased the fees charged to Responders (from $.12 to $.70), but have effected no such increase with respect to Initiating Participant fees.

[5] A detailed explanation of the Exchange's proposed fee structure and resulting price differential is set forth in the Citadel Comment Letter (*See* Letter from John C. Nagel, Managing Director and Sr. Deputy General Counsel, Citadel LLC, to Brent J. Fields, Secretary, Commission, dated July 6, 2016).

[6] 15 U.S.C. 78f(b)(4); 15 U.S.C. 78f(b)(5).

$0.01 (*i.e.*, $0.0001) per share. However, the Exchange minimum quote increment is a full $0.01 per share. Thus, in order to comply with the Exchange standard, Market Participants must round their very precise calculations down to the nearest $0.01 increment for bids, and up to the nearest $0.01 increment for offers. It is at this stage that the $0.0083 per share Exchange fee differential gives a discriminatory advantage to Initiators over Responders in the CUBE Auction.[7] Specifically, the Exchange fee structure offers Initiators up to a $0.13 rebate, which enables Initiators to tighten their Spread by $0.13. In contrast, Responders are forced to apply a $0.70 Exchange fee, which widens their Spread by $0.70.

Take for example two Market Participants competing for an order submitted to the CUBE Auction. All is equal between the two Market Participants – both theoretical value and Spread. The only difference is participant type – one is an Initiator and one is a Responder. A simple calculation demonstrates that across an infinite number of hypothetical theoretical values for a given $0.01 quote increment option, the Responder will be forced to show a worse price in a CUBE Auction 83% more of the time than the Initiator, solely as a result of the discriminatory Exchange fee. The 83% calculation is *only* dependent on the Exchange fee differential and the minimum quote increment ($0.0083/$0.01 = 83%).

In short, the Commission's concerns regarding the discriminatory nature of the Exchange's proposed fee structure and its effects on competition are indeed well founded. By charging disproportionately larger fees to Responders than it charges to Initiators, the Exchange's fee structure effectively eliminates the ability of Responders to price improve vis-à-vis an Initiator in the CUBE Auction. This enables Initiators to become the only participant to a trade to a majority of their customer orders, which is effectively internalization. As a result, the CUBE Auction no longer serves as a price improvement mechanism for the benefit of customers, but rather, is an internalization mechanism for Initiators, enabled by exchanges utilizing discriminatory fee structures.

For the sake of brevity, our analysis above does not include so-called "break-up" credits, paid by the Exchange to Initiating Participants who do *not* participate on a trade.[8] This credit, in our view, only further increases the anti-competitive nature of the Exchange's fee structure. By transferring part of the economic value of the Responder fee ($0.70) to the Initiator (who receives a $0.35 credit) – *not* to the customer – *the break-up credit essentially rewards Initiators for failing to offer price improvement to customers*, and penalizes Responders, who, absent the discriminatory Exchange fees, indeed would have been able to offer such price improvement. This appears to be a very generous incentive offered by the Exchange to Initiators to *avoid* offering price improvement to customers.

---

[7] As noted above, the $0.83 Exchange fee differential is comprised of a $0.13 Exchange fee rebate (credited to Initiators) and a $0.70 Exchange fee (charged to Responders).

[8] The Proposal increased the "break-up" credit payable to an Initiating Participant from $.05 to $.35 in Penny classes. No such credit is offered to Responders.

C. An Industry-Wide Review of Fee Structures Applied to Price Improvement Auctions is Required.

The discriminatory nature of the Exchange's CUBE Auction fee structure is not limited to the Exchange. Rather, as demonstrated in the table below, it is an industry-wide issue that requires immediate attention.

Exchange	Mechanism	Responder Fees	Initiator Fees (Rebates)[9]	Net Difference
AMEX	CUBE	$ 0.70	$ (0.13)	**$ 0.83**
BOX	PIP	$ 0.65	$ (0.11)	**$ 0.76**
CBOE	AIM	$ 0.45	$ (0.10)	**$ 0.55**
Gemini	PIM	$ 0.05	$ 0.05	**$ -**
ISE	PIM	$ 0.05	$ 0.05	**$ -**
MIAX	PRIME	$ 0.50	$ (0.16)	**$ 0.66**
PHLX	PIXL	$ 0.38	$ (0.09)	**$ 0.47**

It should be noted that ISE and Gemini have avoided using discriminatory fees between Responders and Initiators, having a fee differential of zero between both. That said, we do not believe the market has embraced this model "level playing field," but rather, has gravitated towards, and thus, incentivized those markets utilizing the most discriminatory fee structures. Unfortunately, due to the frustrating lack of available data from exchanges regarding activity in auction mechanisms, we cannot independently validate that Price Improvement Mechanisms are indeed used for price improvement. In fact, to the contrary, it appears that internalization is not merely a consequence of the discriminatory fees, but rather, the *intent* of the discriminatory fees – not only in the Exchange's CUBE Auction, but across the industry. This view is supported by the fact that the Exchange saw a 25% decrease in the initiation of CUBE Auctions in February 2016 following the Exchange's implementation of the February CUBE rates, which decreased the fee differential.[10] Accordingly, Optiver US urges the Commission to expand its review of exchange fee structures to include all exchanges offering price improvement auctions with discriminatory fee differences among participants.

D. Responses to Commission Requests for Comment.

The impact of the proposed fee changes on incentives for non-Initiating Participants to respond in the CUBE Auction; the impact of the proposed fee changes on incentives for non-Initiating Participants that respond in the CUBE Auction to offer price improvement.

As outlined in our letter above, all else being equal, Optiver US as a Responding Participant would not price improve for a CUBE Auction order 83% of the time in a $0.01 minimum quote option relative to an Initiating Participant.

[9] Initiator Fees are shown net Initiating Participant exchange rebates and any additional tier-based customer rebates.

[10] *See* Letter from Elizabeth King, General Counsel and Corporate Secretary, NYSE MKT LLC, to Brent J. Fields, Secretary, Commission, dated July 8, 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.")

The impact of the proposed fee changes on the quoting behavior of market makers on the Exchange.

We can use the same logic of fee differentials as we did above, when comparing our behavior when quoting in the outright market ("Quoter"), and being a Responder to a CUBE Auction. In this new case, our fee for trades done as Quoter is $0.25, while our fee as a CUBE Auction Responder remains $0.70. This means the fee differential between Quoter and Responder is $0.45. Thus, in $0.01 minimum quote options, we would actually be expected to widen out from our original quoted price 45% of the time, again due to discriminatory Exchange fees charged to Responders.

Whether the Commission should undertake a broader review of the fee structures applied by the options exchanges to their price improvement auctions.

As mentioned above, we wholly endorse a broader review of options exchange price improvement auctions, and fee schedules in general, with a focus on discriminatory fee differences among participant types, rather than absolute fee levels themselves.

Whether the Commission should view a specific auction response fee level for Penny classes, such as an amount exceeding half the minimum trading increment, as presumptively unreasonable, unfairly discriminatory, imposing an unnecessary or inappropriate burden on competition, or otherwise inconsistent with the Act.

Optiver US takes issue with unfairly discriminatory fee differentials *between participant types*, rather than specific auction response fee levels, which we consider to be arbitrary. Put another way, if the CUBE Auction fee was set at $0.70 for both Responders and Initiators, the fact that the fee level in Penny classes exceeded half the minimum trading increment would not be viewed as a burden on competition by Optiver US. That said, it is important to note that a $0.70 CUBE Auction fee – even if equally applied to Initiators and Responders – would undoubtedly hinder Price Improvement to the end customer, because, as illustrated above, exchange fees have the effect of widening Spreads. However, if all exchanges were prohibited from discriminating between participant types in Price Improvement auctions, we believe response fee levels would be expected to find a reasonable level determined by market forces and true competition between exchanges. This reasonable fee level would most certainly be *much less than half* the minimum trading increment. Indeed, it must be noted that ISE and Gemini already offer non-discriminatory fees between participant types, at a level of 5% of the minimum trading increment. On the other hand, placing an arbitrary auction response fee level *for Responders* for Penny classes, such as an amount equal to half the minimum trading increment ($0.50), still would allow an exchange to provide for any of level of rebates for Initiators that ***could produce fee differentials that are even more discriminatory*** than the $0.83 observed in the Exchange CUBE Auction filing. We would expect all exchanges to set their Responder fee levels to this arbitrary $0.50 level and continue to provide generous Initiator rebates if the discriminatory treatment between the two participant types is not addressed first.

Whether transaction fees that exceed half of the minimum trading increment in Penny classes make participation uneconomical for potential auction responders, given that they may not be able to compete with the Initiating Participant at the same trading increment due to the impact of such fees.

As mentioned in our letter and our previous response, our ability as a Responder to compete with an Initiator on price, all else equal, ***is based only on the differential in fees***, regardless of whether Responders' fees exceed half of the minimum trading increment or any other arbitrary level.

Whether the Commission should view a specific differential in the net fees imposed by an exchange on Initiating Participants and potential auction responders as presumptively inconsistent with the Act and, if so, what that differential should be.

For the reasons set forth above, yes, the Commission should view a differential in the net fees imposed by an exchange on Initiating Participants and potential auction Responders as presumptively inconsistent with the Act. We believe there should be no fee differential between Responders and Initiators.

Optiver US thanks the Commission for the opportunity to comment on the Proposal. If you have any additional questions, please do not hesitate to contact us.

Sincerely,

Sebastiaan Koeling
Chief Executive Officer, Optiver US LLC