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June 23, 2010

Elizabeth Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Comments Regarding Proposed Amendments to Rule 610 of Regulation NMS; Release No. 61902 (File No. S7-09-10)

GETCO

Dear Ms. Murphy:

Global Electronic Trading Company ("GETCO" or "Firm") appreciates the opportunity to comment on the Securities and Exchange Commission's (the "Commission") proposal to limit exchange "access fees" for listed options and prohibit exchanges from imposing discriminatory terms that inhibit access to quotations in listed options (the "Proposal").

The Proposal would amend Rule 610(c) of Regulation NMS to prohibit an exchange from imposing any fee for the execution of an order against a quotation that is the best bid or best offer of such exchange in a listed option that exceeds more the $0.30 per contract (or $0.003 per share). The Proposal would also extend to the listed options market Rule 610(a) of Regulation NMS, which prohibits an exchange from imposing unfairly discriminatory terms that prevent or inhibit indirect access to the exchange's quotations in NMS stocks by nonmembers.

GETCO supports the Commission's stated goals of fair and efficient access to quotations in the listed options markets. We believe, however, that exchange pricing should be determined by market forces instead of the Commission and the imposition of artificial fee caps on maker-taker exchanges would lead to a decrease of competition among liquidity providers on all options exchanges and result in inferior prices for investors.

I. <u>Introduction</u>

GETCO is a leading electronic trading and technology firm providing liquidity on over 50 markets in North and South America, Europe, and Asia. We are a registered market maker on various equity and option exchanges and a Designated Market Maker (DMM) and Supplemental Liquidity Provider ("SLP") on the New York Stock

Exchange ("NYSE").[1] From offices in Chicago, New York, London, and Singapore, the firm transacts business in cash and futures products across four asset classes – equities, fixed income, currencies and commodities. We also provide investors with access to dedicated liquidity through an Alternative Trading System ("ATS"), GETCO Execution Services, or GES. GETCO's primary trading strategy is market making—posting two sided markets—to help investors efficiently transfer the risk commonly associated with assets such as stocks, bonds, commodities and options contracts.[2] Our trading strategies employ advanced technology, real time information, transparent risk management systems and continuous innovation.

II. General Observations Regarding the Proposal

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The debate about fee caps in the options market is not new. In September 2008, GETCO submitted a comment letter to the Commission on this issue in response to calls by proponents to implement a $0.20 fee cap.[3] As we outlined in our September 2008 letter, implementing an artificial fee cap in the options market would be a drastic step and the Commission should forego introducing any actions that would restrict the current competitive environment among options exchanges. Nearly two years later, the options market continues to grow and competition is even more intense. This continued competition, combined with the expansion of the penny pilot program and a shifting market structure, has produced numerous benefits to retail investors in the form of tighter spreads, lower execution costs, and greater access to liquidity. It is GETCO's belief that imposing a fee cap in the options market at this time will severely diminish the progress achieved and will hurt the overall quality of the options markets.

The Commission should continue to allow market competition to determine the appropriate exchange fee structure, including the amount an exchange may charge for taking liquidity. Rather than simply limiting access fees, the Commission should instead study all forms of inducement arrangements. By doing so, the Commission can take a uniform approach to regulating exchange fees, which will ensure that competition among market centers remains robust.

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1 Registered Equity Market Maker: Nasdaq, NYSE Arca, and BATS; Designated Market Maker and Supplemental Liquidity Provider: NYSE; Registered Option Market Maker: Chicago Board Options Exchange, Nasdaq Options Market, BATS Options, and NYSE Arca Options.

2 In GETCO's view, one of the primary purposes of a financial market is to allocate risk to those persons or entities best able to bear it. As those entities do not necessarily meet in time, place, size, or counter preference, market makers and liquidity providers such as GETCO commit their own capital and assume a variety of financial risks until a natural counterparty can be found.

3 *See* Letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission, regarding NYSE Arca's Proposed Rule Change to Amend its Schedule of Fees and Charges (September 2, 2008).

III. <u>GETCO's Views of Specific Aspects of the Proposal</u>

A. Market Forces Should Determine Exchange Fees

GETCO believes exchange fee levels should be determined by market forces and the Commission should refrain from any action that would effectively fix exchange pricing or rates, especially when its decision would directly impact the intense competition between options exchanges.

As the Commission noted in the Proposal, two distinct competing business models have emerged in the options market -- the traditional payment for order flow structure ("PFOF") and the newer maker-taker structure. Each model provides investors with differing costs and benefits and, until now, the Commission has not attempted to regulate exchange fees on these markets. Most empirical evidence suggests that retail options investors now enjoy better prices (tighter spreads), in large part as a result of the competition maker-taker exchanges have brought to traditional PFOF exchanges. Any change to the dynamic that effectively limits the ability of maker-taker exchanges to compete with traditional PFOF exchanges risks negating such benefits and result in higher costs for investors.

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The Commission notes in the Proposal that the proposed access fee limitation would limit the "distortive effects of high fees on quoted prices." Any fee will distort or have an effect on the overall price paid for a security, either in the form of a direct charge (e.g., an access fee) or a higher price (e.g., a wider spread). With respect to access fees on maker-taker exchanges, it is only where taker fees are excessive that they can lead to a distortion in pricing leaving the customer worse off for having been routed.

As we noted in our September 2008 letter, a retail customer options order that is routed from a PFOF exchange to a maker-taker exchange with a better price will always receive better all-in pricing as a result, as long as the access fees are less than the minimum trading increment. So if the maker-taker exchange is providing better pricing by $0.01 or one penny (the equivalent of $1.00 per options contract) and the all-in fee (including the liquidity taker fee) is $0.99 or less, the customer will benefit if the order is routed there for execution. If the access fee is $1.00 or more, the customer will be disadvantaged as a result of the order being routed to a maker-taker exchange. We are not aware of any fees that approach this level and the highest take fee noted in the Proposal is $0.45 per contract. In contrast to the transparent taker fees charged on maker-taker options exchanges, the opaque payment for order flow arrangements collected by traditional options markets -- funded by market makers who execute on those markets and paid to retail brokers to attract their customer order flow -- is the true cause of price distortion in the options markets and should be closely scrutinized. When a market maker is charged a PFOF fee by an exchange to interact with customer orders, the market maker offsets the added fee by incorporating it into the spread between its quoted bids and offers, thus passing the cost along to customers in the form of worse execution prices. And, all customers who trade on PFOF exchanges are impacted by these hidden costs.

Although the Commission has routinely expressed concern about the potential distortive effects of payment for order flow on the options markets, it has, to date, refrained from limiting or eliminating it and instead allowed market forces to determine the propriety of the practice. Payment for order flow in the options market has thrived until recently, when competing business models finally emerged to challenge the arrangement. As a result of the competition between maker-taker and PFOF exchanges, payments for order flow have been under pressure and options customers have benefited. The Commission should refrain from rate fixing through establishing access fee caps and instead allow market forces to continue to dictate exchange fees, which will allow the intense competition between the options exchanges to continue.

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B. Significant Differences Exist Between the Options and Equity Markets

One of the purported reasons for applying a fee cap in the options market is to mirror a similar fee cap in force in the equities market. This view fails to consider that differences exist between the two markets. First, unlike the single market structure of the equities market, the options market supports two separate and very distinct market structures -- the maker-taker model and the PFOF model. Under the maker-taker model, market participants are assessed a fee for taking liquidity and/or given a rebate for providing liquidity. In the PFOF model, members are assessed a fee for trading with customer orders, and a portion of the fee is rebated to order routing firms. The equities market structure is not divided among such different and competing market models. As a result, a fee cap in equities similarly affects all equity exchanges whereas a fee cap in options disproportionately affects maker-taker exchanges as compared to PFOF exchanges. Second, the equities and options markets have had very different experiences with respect to payment for order flow. As noted by Commission Staff in the 2007 Options Study, "payment for order flow and internalization practices have become more pervasive than they were in 2000, which is in contrast to the experience in the equities markets, where payment for order flow decreased substantially following the move to quoting in penny increments."[4]

So while the reasoning that options market should be subject to a similar fee cap in the equities market sounds logical, it fails to appreciate significant distinctions between the equity and options markets, most notably that the options market is still transitioning to a penny quoting increment and maker-taker exchange pricing is still a recent development.

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4 *Report Concerning Examinations of Options Order Routing and Execution,* Office of Compliance Inspections and Examinations, Office of Economic Analysis, and Division of Market Regulation, March 8, 2007.

C. The Commission Should Take a Uniform Approach to Fee Caps

As noted by the Commission, options exchanges have adopted one of two general business models, a PFOF model (the Proposal refers to this as a "broker payment" structure) or a "maker-taker" model. Each one recognizes the value of order flow and is characterized by its use of differing methods to attract such flow. PFOF models attract order flow by paying retail brokerage firms for sending them their customer orders,[5] while maker-taker models attract order flow by offering better execution prices because they reward market makers who quote aggressively with rebates. While certain market participants would prefer the Commission deal separately with taker fees and PFOF, these issues are too closely related to be divorced and essentially involve the same issue – who pays for and who receives payment for liquidity.

The advent of maker-taker pricing in the options markets has resulted in numerous benefits for the options market generally and for customers trading on those markets. Options investors today -- including retail investors -- are receiving better executions and substantial price improvement because of the intense price competition that results from liquidity providers making markets in penny increments on maker-taker options exchanges. Maker-taker fees are transparent and apply equally to all participants. Market makers, non-market maker broker-dealers, and customers are all eligible to receive maker rebates and be charged taker fees, depending on their activity. In this sense, a maker-taker model is a democratic structure that rewards any participant that provides liquidity and charges those who consume liquidity. In addition, all market participants – sophisticated and retail customers – can readily determine rebates and take fees in effect at maker-taker exchanges. In contrast, payments made in exchange for order flow are opaque, ill-understood by most retail investors, bestowed only on certain privileged market participants, and difficult for customers to determine whether they have been passed along by their broker.

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Until now, the competing models have been allowed to evolve and thrive in response to meeting the differing needs of customers. The Proposal focuses on limiting access fees, which covers taker fees but does not include PFOF fees. This represents a potentially major change to the business model of maker-taker exchanges that will affect competition among all options exchanges.

Any change or cap to the structure of one model should be applied to the other model, regardless of whether the limit covers access fees (such as taker fees) or other exchange fees like PFOF. By focusing on taker fees but failing to tackle PFOF, the Commission would leave unaddressed significant order routing/liquidity inducement arrangements. Put another way, a cap on access fees that affects the rebate structure of maker-taker model should only be undertaken in conjunction with a review of PFOF

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5 Under exchange-sponsored payment for order flow programs, the exchanges impose fees upon their members to fund payment for order flow collectively. Such exchange fees are designed to require all market makers that trade with customer order flow on the exchange to contribute to the cost of attracting that order flow. The exchanges collect the fees and allow the specialist firms to direct payments to order routing firms as they deem appropriate.

arrangements of the broker payment model. If both taker fees and PFOF were instead subject to similar caps, customers would have the ability to consider the maximum fees they could be charged for executions across all options exchanges.

D. If a Taker Fee Cap is Imposed, Step-Ups Should be Banned

In response to a recent proposal to amend Rule 602 of Regulation NMS to effectively ban marketable flash orders or step-up orders in NMS securities, the Commission received several comment letters that discussed access fees in listed options. A recurring theme expressed by proponents of step-up orders was that the absence of a limit on fees an options exchange can charge for accessing its quotation was one of the primary reasons banning step-up orders would be more detrimental to listed options customers than banning flash orders would be to cash equity customers. According to these arguments, unlike in the equity markets where investors have the ability to avoid excessive fees by executing off exchanges through an ATS or with market makers who internalize, options investors lack a choice about where they execute. If the Commission determines to impose a fee cap that limits taker fees, it should concurrently ban the use of step-ups in the options exchanges.

E. The Commission Should Study Inducement Arrangements

NYSE Euronext recommended the Commission direct the Division of Trading and Markets to conduct a comprehensive study not only of the fee structures of options exchanges, but also the financial inducements offered by such exchanges to attract order flow. We concur with the proposal by NYSE Euronext. The Commission should conduct a comprehensive study prior to imposing a limit on access fees, especially without concurrently addressing payment for order flow arrangements. A study should focus on the extent to which particular inducements distort pricing and further or impede the development of a fair and orderly market for the trading of listed options contracts.

F. The Proposed $0.30 Cap is Arbitrary

If the Commission determines to impose an access fee cap of some kind, we believe the currently proposed cap of $0.30 per contract is not the correct level. Any fee cap should be a percentage of the minimum trading increment and, at least initially, set towards the higher end of the scale.

As discussed above, a retail customer options order that is routed to a maker-taker options exchange that has a better price and transparent access fees that are less than the minimum trading increment will always receive a better price than on a traditional options market where PFOF skews pricing and negatively impacts best execution. So even with an all-in fee of $0.99, customers still come out ahead when they are routed to a maker-taker exchange and obtain a better execution. Therefore, any cap on access fees set substantially below $0.99 per contract appears arbitrary. By comparison, a review of SEC Rule 606 Reports indicates payment for order flow arrangements range up to $0.75 per contract.

G. Proposed Amendments to Rule 610(a)

The Commission also proposes to extend to the listed options market Rule 610(a) of Regulation NMS, which prohibits exchanges from imposing unfairly discriminatory terms that prevent or inhibit indirect access to the exchanges quotation in NMS stocks by nonmembers. GETCO agrees with the Commission that fair and efficient access to displayed quotations is vital for the smooth functioning of intermarket trading, and thus supports the Commission's proposal to extend the anti-discrimination prohibition to NMS securities, which include listed options as well as NMS stocks.

H. The Commission Should Scrutinize Participant Differentiation in the Options Market

GETCO

GETCO believes an important market structure issue in the options market the Commission should be considering is customer differentiation. Certain options exchanges differentiate among market participants with respect to the fees they charge. We believe it is important to recognize that the fee structure for maker-taker exchanges, which generally apply maker/taker fees without differentiating among market participants, provides compensation to those participants who are willing to trade with any counterparty. This is in stark contrast to the customer differentiated fee structure offered by other exchanges, which effectively protects certain market participants from meaningful competition and may perversely tax competing market makers. GETCO believes distinctions with respect to fees -- or other elements such as technology -- based upon account designation or market participant is an important issue that raises fair access concerns and should be reviewed by the Commission. Presently, different classes of market makers have a differential fee structure, different participation rights, unique data feeds (such as flash/step up orders), and unique programming interfaces that provide them with both lower latency and greater bandwidth over customers and other participants. While it is possible that the Commission may deem these as balanced appropriately versus obligations, we believe a thorough review would be in order when weighing a change of such large competitive implications. These current options market practices seem inconsistent with the principles of fair access, as applied in the equity markets. We believe the fair access principles have promoted competition and should be consistently applied across the equity and options markets.

IV. <u>Conclusion</u>

The listed options market has grown significantly over the last several years as a result of rigorous competition between exchanges. GETCO supports fair and efficient access to quotations in the listed options market, however, we believe that imposing a $0.30 limit on access fees is unwarranted and would diminish competition in the options market, resulting in higher execution costs for long term investors.

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GETCO appreciates the opportunity to submit these comments. Please do not hesitate to contact us at (312) 931-2200 if you have any questions regarding any of the comments provided in this letter.

Sincerely,

John A. McCarthy
General Counsel

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