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VIA E-MAIL AND FEDERAL EXPRESS

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

***Re: Commission Request for Comment on Proposed Rules Regarding
Disclosure of Order Routing and Execution Practices, File No. S7-16-00***

Dear Mr. Katz:

Interactive Brokers LLC and its parent company, The Timber Hill Group,¹ respectfully submit these comments on the Commission's proposed rules to require certain disclosures by

¹ Interactive Brokers is a member The Timber Hill Group, which includes Timber Hill LLC, Interactive Brokers LLC and other affiliates who, through the use of proprietary communications technology, trade stocks, options and futures on organized securities and futures exchanges worldwide. Timber Hill LLC is registered with the Commission as a broker-dealer and is a member in good standing of the Chicago Board Options Exchange, American Stock Exchange, National Association of Securities Dealers, Philadelphia Stock Exchange, Pacific Exchange and International Securities Exchange. Interactive Brokers is a registered broker-dealer and engages exclusively in agency trading. It is a member in good standing of the New York Stock Exchange, the National Association of Securities Dealers, the Chicago

market centers and broker-dealers regarding order routing and execution practices. The proposed order routing and execution disclosure rules, if implemented, will be a major step forward in improving investor awareness of the real costs they pay, both in time and money, for trade execution. We also concur with the Commission's view that the objective, statistical data that will be produced and published by exchanges and other market centers pursuant to the new disclosure rules may reveal a need for further Commission action to address the problems arising from certain widespread market practices (such as market makers creating for themselves "free options" when assigning the execution price of an order during the brief time period surrounding the order's receipt by the market maker).

We submit this comment letter to address two issues raised by the Commission's proposed rules. First, we urge the Commission to apply strict timing and audit trail criteria in examining market center execution quality, and to enforce these criteria rigorously. The proposed rules are correct to require a market center receiving an incoming order to time stamp such order within one second of receipt. We suggest that the Commission make this requirement even more specific by defining the term *time of order receipt* in proposed rule 11Ac1-5(a)(20) as: "the time (to the second) that an order was received by the market center computer system or local area network in which the execution price will be assigned to the order if executed at that market center."

Second, we urge the Commission to apply the proposed execution quality disclosure rules to listed options markets as well as to the markets for National Market System securities. As discussed below, although no consolidated BBO is yet calculated and disseminated for listed options, the quotation data provided by each exchange and through OPRA are sufficient to allow

Board Options Exchange, the American Stock Exchange, the Philadelphia Stock Exchange, the Pacific Exchange and the International Securities Exchange.

the same statistical data to be generated with relative ease for options markets as for National Market System Securities.

I. The Commission Should Strictly Define and Enforce the Timing and Audit Trail Criteria Used to Calculate Execution Quality Statistics

As the Commission is well aware, a potential for abuse exists where a market center receives a marketable order and can delay, even briefly, assigning an execution price to that order. For example, a market maker executing captive market orders pursuant to an internalization or payment for order flow arrangement who has agreed to “step up and match” the NBBO can create for itself a free option by monitoring market movements before and/or after receipt of an order and assigning as an execution price for that order whatever “NBBO” is most favorable to the market maker during the brief option period. This is similar to the “backing away” problems that have been faced by Nasdaq order entry firms when market makers grant to themselves a 10-15 second free option after receipt of what should be a liability order.

In order to prevent market centers from engaging in these practices, it is essential that the execution quality statistics produced under the proposed rules be based on very strict audit trails that indicate with high resolution exactly when an order was received and when the execution price was assigned. It is our hope that the execution quality statistics to be produced pursuant to the Commission’s mandate will reveal when market centers are using a time window surrounding their receipt of an order to step up and match whatever “NBBO” is least favorable to the customer.

We strongly support the proposed requirement that incoming orders be time-stamped within one second but we are wary that even the slightest lack of clarity as to “time of receipt”

can create a window for abuse. We therefore propose that the definition of the term *time of order receipt* in proposed rule 11Ac1-5(a)(20) be amended to read as follows:

“The term *time of order receipt* shall mean the time (to the second) that an order was received by the market center computer system or local area network in which the execution price will be assigned to the order if executed at that market center.”

We agree with the Commission’s proposal that an order should not be considered as having been received by a market center until it is transmitted to the department of the relevant firm responsible for making a market in the security. Nonetheless, under the current proposed definition of *time of order receipt*, there still could be some debate about what constitutes time of receipt within that department. By using the objective criteria of time of receipt by the computer system or local network that will assign an execution price to the order (whether that price itself is assigned automatically or by manual operation on the computer), the definition proposed above will reduce any potential ambiguity.

II. The Proposed Execution Quality Disclosure Rules Should Apply to Listed Options.

As noted, we strongly support the basic principles behind the proposed rules and we think that the Commission’s specifications of the data, statistics and disclosures to be provided under the rules are well thought-out and will be highly informative to the Commission and to the investing public. We disagree, however, with the Commission’s tentative conclusion to exempt options markets from the proposed rules “because a consolidated BBO is not, at this time, calculated and disseminated for options trading.” Based on our experience in options trading -- both as a very active market maker operating on all the U.S. options exchanges and as a brokerage firm routing orders based on our proprietary order-by-order Best Execution routing software -- we respectfully suggest that the quotation data provided by each exchange and

through OPRA are sufficient to allow the same statistical data to be generated with relative ease for options markets as for National Market System Securities. While we agree that it would be useful and should be mandated that a consolidated BBO be calculated and disseminated for listed options, the existing options exchanges can and should calculate the execution quality statistics specified by the proposed rules based on currently available data.

In that regard, the Commission's proposed Firm Quote and Trade-Through Disclosure Rules for Options, Exch. Act Rel. No. 43085, 65 Fed. Reg. 47918 are instructive. Under these proposed rules, issued the same day as the current proposal, broker-dealers would be required to disclose to their customers in each instance of a trade-through: a) that the customer's order has been executed at a price inferior to that available on another market; and b) the price that was posted on that other market at the time of execution. This information is to be provided to broker-dealers by the market centers themselves (subject to the exception that the disclosure requirement does not apply if the order has been executed on an exchange that is a participant in a Commission-approved linkage plan).

The trade-through disclosure obligation proposed by the Commission is based on the well-founded premise that, even without dissemination of a single consolidated BBO, the options market centers currently are aware of each others' quotes at all times during the trading day, and how such other markets' quotes relate to theirs. Indeed, most or all option markets already have rules that are specifically premised on real-time knowledge of other markets' prices (for example, rules to the effect that automatic executions will not be issued when another market is posting a better price, and related automatic step-up rules). Since the options exchanges currently monitor each others' prices, they have the ability, and should be required to, calculate and publish the same execution-quality information that is required for NMS securities under the proposed rules

*(it is worth noting that the Firm Quote and Trade-Through Disclosure Rules include an exemption for time periods during which quotes are suspect due to unusual market conditions or queuing of OPRA message traffic. See 65 Fed. Reg. at 47924. Such periods could also be excluded from the statistics required to be calculated by options markets if the proposed execution quality disclosure rules are applied to listed options.)*²

Further evidence that meaningful execution-quality statistics can be gleaned with comparative ease based on current options market quotation data is available from broker-dealers like Interactive Brokers who provide order-by-order routing of option orders to the best posted market. Order-by-order routing systems monitor the options markets' quotes concurrently, in real-time, throughout the trading day. Thus, barring unusual market conditions or disruption in communications systems, even individual firms can and do compare price and execution data across options markets (both contemporaneously and after-the-fact).

In order to illustrate this point, Timber Hill and Interactive Brokers are in the process of compiling statistical information regarding execution quality across options markets, which we will provide to the Commission shortly. Our reports include statistics regarding, among other things, the spread of the National Best Bid and Offer throughout the trading day (*i.e.*, the percentage of time throughout the day that the spread is zero, 1 tick, 2 ticks etc.); how often during the trading day each exchange is quoting at the NBBO, 1 tick away, 2 ticks away, etc. for each exchange; and the average realized spread calculated pursuant to the criteria identified in the Commission's proposed rules. The reports that we are producing are not in precisely the same format as the reports that the Commission would require because they have been compiled

² Likewise, the Commission's recent settlement of an enforcement action against the options exchanges for anti-competitive behavior requires the exchanges to create a Consolidated Order Audit Trail System. See Exch. Act. Rel. No. 43268 (Sept. 11, 2000). Like the trade-through disclosure rules, this will also

for our own purposes. Our reports demonstrate, however, that the options markets are susceptible of the same type of comparative statistical analysis as the markets for NMS securities, notwithstanding the fact that no formal consolidated BBO is yet disseminated.

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Again, we commend the Commission for proposing useful, common-sense requirements for disclosure of execution-quality information, and we urge that these requirements be extended to the increasingly important markets for listed options.

s/ Thomas Peterffy

Thomas Peterffy
Chairman

s/ David M. Battan

David M. Battan
Vice President and General Counsel

cc: Hon. Arthur Levitt
Hon. Isaac C. Hunt, Jr.
Hon. Paul R. Carey
Hon. Laura Simone Unger
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require exchanges to maintain the type of data that would form the basis for the statistics specified in the proposed execution quality disclosure rules.