February 7, 2011

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 29549-1090

Re: SEC Release No. 34-63403; File No. SR-BATS-2010-034

Dear Ms. Murphy,

IMC Chicago, LLC d/b/a IMC Financial Markets ("IMC")[1] appreciates the opportunity to submit this comment letter in response to the proposal by the BATS Exchange Options Market ("BATS Options") to establish Market Maker Price Improving Orders ("MMPIOs") and related Directed Orders (the "Proposal"). According to the Proposal, BATS Options intends to launch a directed order program where members may direct an options order to a specific market maker for potential execution at a price (albeit non-displayed) better than the existing national best bid or offer ("NBBO").

IMC appreciates efforts by exchanges to implement new mechanisms designed to foster displayed liquidity and price improvement. Indeed, we commend BATS Options for including the proposed requirement that market makers be quoting at the NBBO in order to be eligible to interact with directed orders. In fact, we respectfully suggest that the Securities & Exchange Commission ("Commission") compel other options exchanges to follow suit and revise their respective price improvement / directed order rules to require market makers to be at the NBBO in order to qualify for the typical 40% guaranteed allocation at the end of the exposure period and auction.

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[1] IMC is a proprietary trading firm and registered broker-dealer, engaged in providing liquidity in nearly every listed equities and derivatives market in the U.S. In addition, IMC is part of a global firm with affiliates trading in Amsterdam, Zug, Sydney, and Hong Kong. IMC is a registered market maker in U.S. exchange listed products. As a market maker, IMC establishes two-sided markets which serve to aid investors in their effort to mitigate or transfer risk. IMC's market making strategies use sophisticated risk management controls and innovative technology to safeguard the integrity of its electronic trading system.

However, as discussed in greater detail below, the Proposal incentivizes non-displayed pricing, without any meaningful opportunity for competition or price discovery. Accordingly, the BATS Options Proposal should not be approved.

<u>Discussion</u>

A. Unlike Price Improvement Mechanisms on Other Exchanges, the BATS Options Proposal Fails to Offer Meaningful Competition or Price Discovery Opportunities

As proposed, market makers on BATS Options may submit orders at a displayed price which are actually eligible for execution at a better non-displayed price. Moreover, only certain market participants identified in advance by the market maker are eligible to receive executions at the better non-displayed price. The structure of this Proposal is distinct from price improving mechanisms offered by other exchanges, which are designed to foster competition among all market participants. The Price Improving Mechanism ("PIM") on the International Securities Exchange, LLC ("ISE"), for example, is exposed for one second to all ISE participants, during which they have an opportunity to indicate the size and price at which they want to participate. At the conclusion of the exposure period, directed orders on the ISE are executed in full at the best prices available, with up to 40% guaranteed to the originating member. This exposure period and auction facilitates meaningful competition and the possibility of further price improvement. No such exposure and auction process is proposed by BATS Options. Instead, MMPIOs will execute against incoming Directed Orders—up to their full size and at their undisclosed price—as long as (i) the displayed price of the MMPIO was at the NBBO and (ii) there are no other orders on the BATS Options book equal to or better than the non-displayed price of the MMPIO. This structure limits competition, does not contribute to price discovery, and allows market makers to internalize up to 100% of the directed order flow—to the detriment of customers. For example, where two market makers have entered MMPIOs in the same series, with one offering a non-displayed price two cents better than the other, the Proposal permits the worse of the two MMPIOs to execute against a Directed Order. Customers are necessarily disadvantaged in that better prices were available, but since the order was not exposed, participants were unable to compete for the execution and therefore, true price discovery did not occur. By establishing a better non-displayed market for select market participants, BATS Options is not only outside the bounds of previously approved price improvement mechanisms, but it is effectively relegating non eligible market participants to second class status, preventing them from contributing to or benefiting from meaningful price improvement. Such a flawed process should not be permitted.

B. Discrepancy between MMPIO and PIO Raises Issues in Penny Eligible Symbols

According to the Proposal, BATS Options participants may enter Price Improving Orders ("PIOs") to buy or sell an option at a specified price *at an increment smaller than the minimum price variation in the security, as small as one cent or at the midpoint of the NBBO.* MMPIOs, on the other hand, may be entered *in increments as small as one cent or designated at the midpoint of the NBBO*—without being restricted to increments smaller than the minimum price variation. This difference, though subtle, has potentially far reaching consequences in options with penny trading increments particularly if the Commission is not inclined to allow designating PIOs or MMPIOs at the midpoint or sub-penny increments. In other words, without the ability to designate PIOs at the midpoint for options eligible to trade in one cent increments, non-market makers would not have the ability to enter a non-displayed PIO since they would not be able to effect a non-displayed price "at an increment smaller than the minimum price variation"—one cent. If that is the case, market makers submitting MMPIOs will be singularly positioned to benefit from directed orders in penny eligible options, since MMPIOs are not similarly restricted.

We are not, however, advocating sub-penny pricing to resolve this issue. Instead, the Commission should require BATS Options to clarify that MMPIOs, like PIOs, may only be submitted in increments smaller than the minimum price variation (tick size) in the security. In other words, market makers should not be permitted to submit hidden prices in increments equal to the prevailing tick size, particularly for penny eligible symbols. Our markets should incentivize displayed rather than non-displayed liquidity. If market makers are willing to trade penny eligible series at better penny increment prices, for example, than they should be required to display that interest. MMPIOs are not currently restricted in this manner, and as such, market makers may offer price improvement in non-displayed penny increments to a limited and select group of beneficiaries. Not only does this run counter to efforts to incentivize displayed liquidity and foster price discovery, but it also permits market makers to benefit from Directed Orders—up to 100% of the directed flow—without any meaningful competition.

IMC requests that BATS Options modify the proposed operation of MMPIOs so that they, like PIOs, may only be entered at a specified price in increments smaller than the minimum tick size. Otherwise, the displayed markets will inevitably slide further down the slippery slope towards hidden liquidity—to the detriment of all participants.

C. Market Makers May Enter MMPIOS for As Little As One Displayed Contract

As currently proposed, MMPIOs may be entered in conjunction with a reserve order. If so, that would allow a market maker to benefit from the ability to offer both a non-displayed price and a non-displayed size as well. Potentially, by showing as little as one contract at the NBBO, a market maker would be eligible to interact with a Direct Order at its non-displayed price for up to the full size of the Directed Order. Unfortunately, this possibility further incentivizes hidden rather than displayed liquidity. IMC requests that BATS Options eliminate this possibility by clarifying within its rule text that MMPIOs may execute against Directed Orders only up to the full displayed size of the MMPIO.

Conclusion

IMC believes in displayed liquidity. Transparency facilitates competition and price discovery, to the benefit of all market participants. Price improving mechanisms and directed order programs that do not offer meaningful competition or price discovery opportunities, such as proposed by BATS Options, fall short of the standards previously approved by the Commission. As a result, the BATS Options Proposal should not be approved.

IMC appreciates the opportunity to comment on this Proposal. Should you have any questions in connection with our comments, please feel free to contact me at 312-244-3355.

Sincerely,

Andrew Stevens
Legal Counsel

cc:

The Honorable Mary L. Schapiro, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Kathleen L. Casey, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Elisse B. Walter, Commissioner
Robert W. Cook, Division of Trading and Markets
James A. Brigagliano, Division of Trading and Markets
Heather Seidel, Division of Trading and Markets