BOX OPTIONS EXCHANGE

June 13, 2011

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

Re: SR-BATS-2011-009

Dear Ms. Murphy:

Boston Options Exchange Group, LLC ("BOX") appreciates the opportunity to provide additional comment on the above referenced proposed rule change ("Proposal") to create a directed order program on a pilot basis on BATS Exchange, Inc. ("BATS"). BOX has previously submitted two comment letters on the Proposal.[1] BOX continues to have serious concerns about the Proposal and urges the Commission to disapprove.

The most recent iteration of the Proposal provides that an order flow provider ("OFP") directing a customer order to a BATS market maker for price improvement "*may*" designate more than one market maker to receive the directed order. Nothing in the revised Proposal adequately addresses the issues previously raised by BOX and the other options exchanges in comment letters related to the Proposal. The key items within a price improvement auction process are transparency and competition. BATS' Proposal provides neither of these. Of concern is that the lack of competition in the Proposal:

- Is not in the best interest of customers;
- Would result in a very high rate of internalization by BATS market makers; and
- Is inconsistent with the long standing Commission policy emphasizing the importance of transparent competition to ensure that customer orders receive the best price possible.

BOX introduced the price improvement auction process for obtaining customer price improvement, in the face of great controversy, to the options marketplace in February 2004. Since then, customers have received nearly $350 million in savings through better executions on BOX, in addition to likely comparable amounts on the other options exchanges that have copied the BOX concept.

The entire marketplace should be informed that an improvement auction is underway and all participants should be free to submit orders to compete for the customer order. There is no reason to exclude any market participant from this competition, and yet the BATS Proposal will inform *only* those market makers that the OFP has designated and *only* those market makers are allowed to submit competing orders. BATS has provided no justification for how these limitations could possibly be construed as being in the customer's best interest.

If the possibility of competition is entirely at the OFP's discretion, a substantial conflict of interest may arise. The Commission should seriously consider the likelihood that the unregulated payment for order flow ("PFOF") that BATS market makers offer will significantly increase so that they can be the sole destination for an OFP's customer orders. This OFP discretion is in contrast to all price improvement interaction mechanisms at other exchanges where competition is robust and not at the OFP's discretion. BATS asserts that the amended Proposal "reinforces the

[1] See Letters from Anthony D. McCormick, BOX CEO, dated January 20, 2011, and March 29, 2011.

primacy of best price" where multiple market makers compete for the customer order.[2] There can be a "*best*" price, however, only where there are multiple prices available. Permitting an OFP to submit directed orders to multiple market makers does not *require* the customer order's exposure to all other market participants or to an auction mechanism, as other exchange price improvement mechanisms do, thus ensuring some level of competition for the retail customer order.

BATS freely admits that its Proposal provides for the possibility of inferior executions for customer orders where a market maker at the best price is not selected by an OFP to receive its directed orders.[3] In support of this concession BATS states, ". . . the structure of the Proposal empowers the maker [sic] makers to select which firms they wish to commit price improvement to, the Proposal also empowers order flow providers to select which market making firms they wish to preference."[4] This appears to concede that the Proposal creates a private or non-public market where OFPs and market makers, so long as they have negotiated the appropriate relationship between their respective firms, which is likely to include substantial PFOF, can execute transactions with one another without ever exposing the retail customer order to public price discovery or an auction process. The Commission should discourage the development of executions of customer orders outside of a public price discovery process.

BATS asserts that the requirement that its market makers must be quoting at the NBBO or better to be able to receive directed orders, and do so without any participation guarantee, will "foster efficient competition by placing all firms on a more level playing field and incenting effective competition through price."[5] The very high probability of single market maker designation for BATS' directed orders, however, means that internalization rates are likely to reach 100% on such orders, a direct contradiction of the "40% threshold" that has long been the practice in the options industry for order flow interaction (whether "specialist entitlements", facilitation mechanisms, or price improvement auctions). This will have the additional effect of discouraging competition on the regular order book across all of the options market, resulting in further degradation of NBBO spreads, to the detriment of all customers.

If BATS market makers enjoy the security of receiving directed orders from only their list of approved Options Members, then the cost of that enjoyment should be the *requirement* that directed orders be exposed to the market or subject to a specific auction mechanism so that customers enjoy the greatest amount of opportunity for price improvement. Without a requirement for directed orders to be exposed or subject to an auction, customers are denied any possibility of multiple market participants further competing for the order, and potentially providing additional price improvement.

Finally, it would be remarkably inconsistent for the Commission to approve the Proposal without any exposure period while continuing to scrutinize in great detail whether the existing exposure periods on other exchange auction mechanisms provide market participants with a meaningful opportunity to compete for orders. BOX appreciates the opportunity to reiterate its concerns regarding the Proposal's potentially negative impact on the overall marketplace, including its impact on competition and customer price improvement, and again urges the Commission to disapprove the Proposal.

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[2] See Letter from Jeromee Johnson, BATS, dated June 2, 2011, in response to comment letters on the Proposal ("BATS Letter"), at pages 5-6.
[3] See BATS Letter at page 4.
[4] See BATS Letter at page 4.
[5] See BATS Letter at page 4.

Please contact me at (312) 444-6328 if you have any questions regarding this matter.

Respectfully submitted,

Anthony D. McCormick
Chief Executive Officer

cc: Robert Cook, Director, Division of Trading and Markets
James Brigagliano, Deputy Director, Division of Trading and Markets
Heather Seidel, Associate Director, Division of Trading and Markets