imc financial markets

April 21, 2011

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

Re: SEC Release No. 34-64132; File No. SR-BATS-2011-009

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 recently revised proposal by the BATS Exchange Options Market ("BATS Options") to establish Market Maker Price Improving Orders ("MMPIOs") and related Directed Orders (the "Revised Proposal"). According to the Revised 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 an un-displayed price better than the existing national best bid or offer ("NBBO"). For the reasons set forth below, IMC requests that the Securities & Exchange Commission ("Commission") reject this proposal.

In its Revised Proposal, BATS Options has clarified that (i) it will not offer midpoint order functionality, (ii) only the full *displayed* size of an MMPIO may execute against a directed order, and (iii) the Directed Order program will be subject to a pilot period, with certain attendant obligations. Unfortunately, these clarifications do not address our primary concern, namely: the proposed directed order program incentivizes un-displayed pricing, without offering any meaningful opportunity for competition or price discovery.

[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.

Discussion

A. The Revised Proposal Fails to Offer Meaningful Competition or Price Discovery Opportunities

According to the proposal, market makers on BATS Options may submit an order at a displayed price which is actually eligible for execution at a better un-displayed price. Market Makers identify the participants to whom they selectively offer these better, un-displayed prices, without ever exposing those orders to any other market participants. This structure 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. The 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 displayed size and at their better un-displayed price—as long as (i) the displayed price of the MMPIO was at the NBBO[2] and (ii) there are no other orders on the BATS Options book equal to or better than the un-displayed price of the MMPIO. This structure unduly limits competition and as such does not contribute to price discovery. For example, where two market makers have entered MMPIOs in the same series, with one offering an un-displayed price two cents better than the other, the Revised Proposal—by its very terms—permits the worse of the two MMPIOs, in the absence of other orders on the BATS Options book equal to or better than the un-displayed price of the MMPIO, to execute against the Directed Order. Customers are necessarily disadvantaged in that better prices were available, but since the order was not exposed, there was no competition for the execution and true price discovery did not occur. Identical to the first proposal in this respect, this structure remains flawed. Without an exposure period, this process fails to promote competition and price discovery—to the detriment of customers.

B. Price Improving Orders Are Unable to Compete with MMPIOS in Penny Eligible Symbols

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*

[2] Please note, although we are troubled by the overall proposal for the reasons set forth herein, we do commend BATS Options for proposing the 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 Commission compel other options exchanges to 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.

small as one cent. MMPIOs, on the other hand, may be entered *in increments as small as one cent*—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. In other words, in penny eligible series, non-market makers will not have the ability to enter an un-displayed PIO since they would not be able to effect an un-displayed price "at an increment smaller than the minimum price variation"—one cent. Although we generally agree with BATS Options that participants may compete for executions in penny eligible series simply by improving the NBBO, the ability for certain market makers to offer un-displayed price improvement in penny series amounts to a singular benefit that is not otherwise justified by a structure that promotes competition. In fact, because the majority of equity and ETF options volume is in penny eligible series, this discrepancy in functionality between PIOs and MMPIOs is dramatic. Unfortunately, smart order routing functionality further exacerbates this problem by allowing firms to recognize, and capitalize on, opportunities to internalize using MMPIOs and Directed Orders.

C. Additional Relevant Data for the Pilot Program, If the Revised Proposal is Approved

If the Commission is inclined to approve the Revised Proposal, IMC suggests that BATS Options be required to collect and disseminate additional data as part of its proposed pilot program reporting obligations, including:

- Data reflecting how often market makers executed MMPIOs is penny eligible series, where PIOs cannot effectively compete;
  and
- Data reflecting how often Directed Orders execute against an MMPIO at a worse available price than another MMPIO, and the amount of any unrealized price improvement.

<u>Conclusion</u>

IMC believes in displayed liquidity. Transparency facilitates competition and price discovery, to the benefit of all market participants. The proposed directed order program does not offer meaningful competition or price discovery opportunities, and therefore falls short of the standards previously approved by the Commission. As a result, and for the reasons described herein, BATS Options' Revised Proposal should not be approved.

IMC appreciates the opportunity to comment on this Revised 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:

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