



BOXSM
OPTIONS EXCHANGE

March 29, 2011

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

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

Dear Ms. Murphy:

Boston Options Exchange Group, LLC (“BOX”) appreciates the opportunity to comment on the above referenced proposed rule change (“Proposal”) to create a directed order program on BATS Exchange, Inc. (“BATS”). BOX has significant concerns about certain aspects of the Proposal and urges the Commission to disapprove. In particular, BOX believes the Proposal would lead to excessive internalization by BATS Options Market Makers and that their ability to execute against Directed Orders without those Directed Orders first being exposed to all market participants will result in less competition and less price improvement, and will negatively impact customers.

Under BATS’ Proposal, a BATS’ Market Maker Price Improving Order (“MMPIO”) can be entered in increments as small as one penny regardless of the minimum trading increment of the option. BATS Options Market Makers will be able to internalize Directed Orders because the only other orders that might gain priority would be pre-existing non-displayed orders where the non-displayed price is better than the MMPIO non-displayed price. For pre-existing non-displayed interest to interfere with the Directed Order executing against the MMPIO, such pre-existing non-displayed interest would have to be from someone other than a market maker. Permitting MMPIOs to be entered at penny increments provides no real interference to the Market Maker internalizing 100% of its customer order flow.

BOX believes that permitting BATS Option Market Makers’ excessive internalization of customer order flow will provide a powerful disincentive to other Market Makers aggressively quoting and posting liquidity, and cause denigration in the overall market place. With the proposed rule change in place, other Market Makers would have little reason to strongly compete for customer order flow if BATS Options Market Makers that are able to enter MMPIOs can consistently internalize their customer orders. Over the last several years, increased competition among options exchanges has resulted in benefits such as tighter spreads, deeper liquidity, and significant price improvement for customers. All these benefits will be lost or reduced if market makers are able to internalize 100% of their customer orders – a likely scenario under the BATS Proposal.

BATS asserts that the requirement that it’s Market Maker must be quoting at the NBBO or better to be able to enter an MMPIO will create a more competitively quoted market. BOX believes a high probability for internalization still exists. Regardless of communication between the BATS Market Maker and BATS Options Members, a BATS’ MMPIO entered at the NBBO with a non-displayed price of one penny improvement could be immediately followed with a BATS Options Member’s marketable Directed Order at the NBBO and result in an execution against the non-displayed price of the MMPIO, with no exposure to other market participants. Other exchanges, including BOX, require that such an order be exposed to all market participants for at least one second. Critical to BOX’s concern about the Proposal, the lack of a requirement that the Directed Order be exposed to all market participants or be subject to a separate auction



mechanism will prevent all other market participants from any opportunity to provide further price improvement.

If BATS Market Makers will 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. Why should customers be limited to only the \$.01 of improvement of the non-displayed price of the MMPIO order if the market may be willing to provide more? 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.

The Commission has previously required market maker price improvement orders to be exposed to all market participants before a market maker may trade such an improvement order against its own customer order. BOX believes that order exposure to all market participants enables the greatest amount of price discovery, enhances competition and transparency in a market, and additionally diffuses market maker internalization of orders. BATS' Proposal will allow its Options Market Makers to execute against Directed Orders they receive without those orders first being exposed to the market or being subject to an auction mechanism. Such a function would preclude all other market participants from the opportunity to match the order or provide price improvement. Moreover, BOX believes that it would be 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 believes that a lack of exposure of orders to all market participants will result in less competition for orders, and less opportunity for customers to receive price improvement.

The Commission has sought to prevent options exchanges from becoming closed proprietary crossing systems, and has reviewed proposals that have raised concerns about higher rates of internalization with a critical eye. The Commission has done well in its attempts to maintain a balance between rewarding market makers and dealer firms for the liquidity they provide the market, and fostering fair, orderly, and efficient markets that protect small investors. BOX shares the Commission's concern that too much internalized order flow would reduce the order flow in the overall marketplace and negatively impact overall market quality, and urges the Commission to disapprove the Proposal.

Again, BOX appreciates the opportunity to submit these comments on the Proposal. Please contact me at (312) 444-6328 if you have any questions regarding this matter.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Anthony D. McCormick". The signature is fluid and cursive, written over a white background.

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