

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54365; File No. SR-BSE-2006-22)

August 25, 2006

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Order Granting Approval of Proposed Rule Change and Amendment Nos. 1, 2, and 3 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 5 Thereto to Implement the Boston Equities Exchange (“BeX”) Trading System

**I. Introduction**

On May 10, 2006, the Boston Stock Exchange, Inc. (“BSE” or “Exchange”) submitted to the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to implement a new trading system, the Boston Equities Exchange (“BeX”). BSE filed Amendment No. 1 to the proposed rule change on June 2, 2006.<sup>3</sup> BSE filed Amendment No. 2 to the proposed rule change on June 9, 2006.<sup>4</sup> BSE filed Amendment No. 3 to the proposed rule change on June 15, 2006.<sup>5</sup> The proposed rule change, as amended, was published for comment in the Federal Register on June 29, 2006.<sup>6</sup> The Commission received no comments regarding the proposal, as amended. On August 22, 2006, BSE filed Amendment No. 5 to the proposed rule change.<sup>7</sup> This order approves the proposed rule change, as amended, grants accelerated approval

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 replaced and superseded the original filing in its entirety.

<sup>4</sup> Amendment No. 2 replaced and superseded the original filing and Amendment No. 1 in their entirety.

<sup>5</sup> Amendment No. 3 replaced and superseded the original filing, Amendment No. 1, and Amendment No. 2 in their entirety.

<sup>6</sup> See Securities Exchange Act Release No. 54034 (June 22, 2006), 71 FR 37140.

<sup>7</sup> Amendment No. 4 was filed on July 26, 2006. Amendment No. 4 was withdrawn on August 22, 2006. Amendment No. 5 was filed on August 22, 2006. In Amendment No. 5, the Exchange amended BSE Rules Chapter II, Section 41 - Minimum Price Variation

to Amendment No. 5 to the proposed rule change, and solicits comments from interested persons on Amendment No. 5.

## II. Description of the Proposed Rule Change

In a separate filing that is being approved today, BSE proposes to establish a new communications and electronic trading facility,<sup>8</sup> to be known as “BeX.”<sup>9</sup> The BeX facility is a fully-automated electronic book for the display and execution of orders in securities intended for the use of BSE Members, including Electronic Access Members, and their customers.

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to state that the Exchange shall not display, rank, or accept any bids, offers, or orders in a security priced in an increment smaller than \$0.01 if that bid, offer, or order is priced equal to or greater than \$1.00, but that the Exchange may execute and report Mid-point Cross Orders in increments as small as one-half the Minimum Price Variation for the security. In addition, BSE amended the rule text of BSE Rule, Chapter XXXVII to clarify that if an At the Close order is not fully executed at the close, the part of the order not executed will be cancelled; to clarify opening procedures; to indicate more clearly when orders would be routed at the instruction of the Member entering the order; and to clarify how cross orders would be executed in the Post-Primary Trading Session. Further, the Exchange corrected several technical errors contained in the rule text.

<sup>8</sup> Pursuant to Section 3(a)(2) of the Act, the term “facility” when used with respect to an exchange, includes “its premises, tangible or intangible property whether on the premises or not, any right to the use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on an exchange (including, among other things, any system of communication to or from the exchange, by ticker or otherwise, maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.” 15 U.S.C. 78c(a)(2).

<sup>9</sup> BeX is owned and will be operated by BSX Group, LLC (“BSX”), of which BSE is currently a majority owner. See Securities Exchange Act Release No. 54364 (August 25, 2006) (order approving SR-BSE-2006-20), which adopts the proposed governance structure of BSX as reflected in its operating agreement, and proposed changes to the BSE Constitution with respect to the creation of Electronic Access Members and to BSE rules regarding transfer of ownership of BSX units.

In the instant filing, the Exchange proposes rules to implement the initial phase of BeX.<sup>10</sup> In this initial phase, BeX would be BSE's trading facility for any security, other than securities listed on The Nasdaq Stock Market ("Nasdaq"),<sup>11</sup> for which BSE obtains unlisted trading privileges ("UTP") after June 30, 2006. All securities displayed and executed on BeX would be securities that are not assigned to a BSE specialist. BeX would allow Exchange Members, whether or not they are on the Exchange's floor, to enter orders in these securities into the BeX facility for possible execution.

The rules governing BeX would be located in Chapter XXXVII of the BSE's Rules. The bylaws and all other BSE Rules and policies would continue to be applicable to BeX trading except where the context requires otherwise.<sup>12</sup>

**Eligible securities.** In the initial phase of BeX, all securities eligible for trading on the Exchange that are listed otherwise than on Nasdaq for which the BSE has obtained UTP after June 30, 2006 would be eligible to be traded in the BeX.<sup>13</sup> However, any specialist request to remove a security from BeX would be considered by the appropriate committee of the BSE's Board of Directors ("Board").<sup>14</sup>

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<sup>10</sup> The Commission notes that the BSE recently filed a proposed rule change setting forth proposed rules to implement the second phase of BeX and to comply with the Commission's Regulation NMS under the Act, which the Commission has published for comment. See Securities Exchange Release Act No. 54291 (August 8, 2006), 71 FR 47264 (August 16, 2006)(File No. SR-BSE-2006-30)("BeX Phase II Notice").

<sup>11</sup> The BSE rules governing trading in Nasdaq stocks (BSE Rules, Chapter XXXV) and the BSE rules governing trading in listed securities assigned to a specialist (BSE Rules, Chapters I, II, III, XV, XVI, XVII, XIX, and XXXIII) remain unchanged. The Exchange advised that it intends to apply for UTP in securities listed otherwise than on Nasdaq for which it currently does not trade UTP.

<sup>12</sup> See proposed BSE Rule, Chapter XXXVII, Section 7.

<sup>13</sup> This includes securities that are not listed on Nasdaq and securities listed on other exchanges that did not begin trading on BSE prior to June 30, 2006.

<sup>14</sup> See proposed BSE Rule, Chapter XXXVII, Section 1, Paragraph (a).

**Receipt of orders.** Orders could be routed to BeX through the Exchange’s systems or through other communications lines approved by the Exchange for the delivery of orders by Exchange Members.<sup>15</sup> BeX would also accept and automatically execute commitments sent by market centers that participate in ITS.

**Ranking, display, and automated matching of orders.** Except for Cross, Cross with Size, Mid-point Cross orders and Post Primary Cross orders,<sup>16</sup> all orders sent to BeX would be ranked according to their price and time of receipt and would be displayed to the public when they constitute the Best Bid or Offer in BeX for a security. Orders would automatically match against each other, in price/time priority. Specifically, an incoming order would be matched against one or more orders in the BeX, in the order of their ranking, at the price of each order, for the full amount of shares available at that price, or for the size of the incoming order, if smaller.<sup>17</sup> If an incoming order could not be matched when it is received, and it is not designated as an order that should be immediately cancelled, the order would be placed in the BeX.<sup>18</sup>

Under the proposed rules, orders could be entered by a BSE Member on its own behalf, for the account of another Member (collectively, “professional orders”) or for the account of a customer (an “agency order”). However, agency orders would be subject to the same display

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<sup>15</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (h)(i).

<sup>16</sup> See Section on eligible order types for a discussion of BeX-eligible cross orders. Cross, Cross with Size, Mid-point Cross and Post Primary Cross orders would be executed in accordance with BSE Rule, Chapter XXXVII, Section 3, Paragraph (k).

<sup>17</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (j).

<sup>18</sup> See discussion of compliance with the Intermarket Trading System (“ITS”) Plan infra.

and execution processes as professional orders, and agency orders would not receive any priority in order execution or handling.<sup>19</sup>

**Eligible order types.** Orders sent to BeX would be required to be specifically designated in the manner specified by the Exchange for trading in BeX. BeX would accept only round-lot market and limit orders for regular-way settlement.<sup>20</sup>

Orders eligible for execution in BeX could be designated as one of the following existing BSE order types<sup>21</sup>: “At the Close,” “At the Opening or At the Opening Only,” “Day,” “Do Not Increase (DNI),” “Do not Reduce (DNR),” “Fill or Kill,” “Good ‘til Cancel,” “Immediate or Cancel,” “Limit, Limited or Limited Price,” “Market,” “Stop Limit,” or “Stop” orders. Orders could also be designated one of the following new order types in BeX: “Cross,” “Cross with Size,” “Good 'Till Date (GTD),” “Good 'Till Time (GTT),” “Limit or Close,” “Mid-point Cross” or “Post Primary Cross.” Descriptions of the new BeX-eligible order types are as follows<sup>22</sup>:

Cross: An order to buy and sell the same security at a specific price better than the best bid and offer displayed in BeX and equal to or better than the National Best Bid and Offer. A Cross order could represent interest of one or more BSE Members.

Cross with Size: A Cross order to buy and sell at least 5,000 shares of the same security with a market value of at least \$100,000 at a price equal to or better than the best bid or offer

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<sup>19</sup> See proposed BSE Rule, Chapter XXXVII, Section 2, Paragraph (d). The Exchange has represented that current BSE Rule, Chapter II, Section 11, Trading While Acting as a Broker as to Market Orders, would apply to participants' activities on BeX. The rule generally provides that a member may not trade ahead of a customer order it is representing. Telephone call between Brian Donnelly, Assistant Vice President, Regulation and Compliance, BSE, and Jennifer Colihan, Special Counsel, and David Michehl, Special Counsel, Division of Market Regulation, Commission, on August 8, 2006.

<sup>20</sup> See proposed BSE Rule, Chapter XXXVII, Section 2, Paragraph (a)-(b).

<sup>21</sup> See proposed BSE Rule, Chapter XXXVII, Section 1, Paragraph (c)(i).

<sup>22</sup> See proposed BSE Rule, Chapter XXXVII, Section 1, Paragraph (c)(ii).

displayed in BeX and the National Best Bid or Offer, where the size of the order is larger than the aggregate size of all interest displayed in BeX at that price. Neither side of a Cross with Size order may be for the account of the BSE Member sending the order to BeX.<sup>23</sup>

Good 'Till Date (GTD): An order to buy or sell that, if not executed, expires at the end of the date specified in the order.

Good 'Till Time (GTT): An order to buy or sell that, if not executed, expires at the time specified in the order.

Limit or Close: A Limit Order to buy or sell that if not executed prior to the Market on Close cutoff time of 3:40 p.m., pursuant to BSE Rule, Chapter II, Section 22, will automatically convert to an At the Close Order for inclusion in the closing process, and if not so executed at the close, will be cancelled.

Mid-Point Cross: A two-sided order with both a buy and sell component combined that would be executed at the midpoint of the National Best Bid or Offer. A Mid-Point Cross order would be rejected when a locked or crossed market exists in the relevant security at the time the order is received. Mid-Point Cross orders would be permitted to be executed and reported in increments as small as one-half of the Minimum Price Variation.<sup>24</sup>

Post Primary Cross: A single priced cross order entered during the Post Primary Trading Session.

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<sup>23</sup> The Commission notes that the in the BeX Phase II Notice, supra note 10, BSE has proposed, among other things, to amend the Cross with Size provision.

<sup>24</sup> BSE Rules, Chapter II, Section 41 generally sets forth the “Minimum Price Variation” as \$.01. See supra note 7 regarding an amendment the Exchange has made to this proposal with respect to the definition of Minimum Price Variation.

Cross, Cross with Size, Mid-point Cross, and Post Primary Cross orders would be executed automatically if they meet the requirements for those types of orders. If they do not meet applicable requirements, they would be immediately cancelled.<sup>25</sup>

With the exception of Fill or Kill and Immediate or Cancel orders, a customer would be able to append to an order an instruction that the order be routed to the market(s) displaying the National Best Bid or Offer if the order would trade through the National Best Bid or Offer if executed on the BeX. Absent such an instruction, the order would be cancelled.

**Compliance with ITS Plan.**<sup>26</sup> The proposed rules provide that if an order in an ITS-eligible security crosses or locks the National Best Bid or Offer at the time that it is received, the order would be immediately cancelled or, at the instruction of the member entering the order, routed to the market(s) displaying the National Best Bid or Offer to ensure compliance with the ITS Plan's rules relating to locked markets.<sup>27</sup> If an incoming Limit Order would trade through (as defined in the ITS Plan) through the National Best Bid or Offer if executed on the BeX at the time of receipt, it would be either cancelled or, at the instruction of the member entering the order, routed to the market(s) showing the National Best Bid or Offer<sup>28</sup> If an incoming Market Order would trade through the National Best Bid or Offer if executed on the BeX at the time of

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<sup>25</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (k).

<sup>26</sup> The Commission notes that in the BeX Phase II Notice, supra note 10, the BSE proposed further rule changes, among others, to ensure that its rules comply with Rules 610 and 611 of Regulation NMS under the Act. The Commission notes that once Regulation NMS has been fully implemented, the ITS Plan and its requirements will no longer be in effect.

<sup>27</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (i), subparagraph (ii). Similarly, if an order in a listed security locks or crosses the Best Bid or Offer in BeX at the time it is received, the order would be executed on BeX according to BeX's matching algorithm with any remaining portion either immediately cancelled, at the instruction of the member entering the order, routed to an away market center(s).

<sup>28</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (j)(ii).

receipt, it would either be cancelled or, at the instruction of the member entering the order, routed to the market(s) displaying the National Best Bid or Offer.<sup>29</sup>

Inbound ITS commitments, if priced at or better than the current Best Bid or Offer in BeX, would be automatically executed against the order(s) reflected in the Best Bid or Offer for the full amount of shares at that price, and any remaining portion of the ITS commitment would be automatically cancelled.<sup>30</sup>

**Operating hours and trading sessions.** BeX would operate from 7:30 a.m. until 4:30 p.m. during Pre-Opening, Opening, Primary, and Post-Primary Trading Sessions.<sup>31</sup> Specifically, the Pre-Opening would extend from 7:30 a.m. until 9:30 a.m., during which orders could be placed on the BeX but would not be matched and would not generate trade executions. Market participants would be able to add, modify or cancel orders during this period.

The BeX facility would open for trading once the primary market for a security opens on either a displayed quote or trade (the “Opening”).<sup>32</sup> Where the Opening is based on a trade print in the primary market, it would match the primary market opening price for each individual security opened. Once the BeX opening price was determined, all eligible orders priced equal to

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<sup>29</sup> Id. at Paragraph (j)(iii).

<sup>30</sup> Id. at Paragraph (j)(iv).

<sup>31</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraphs (a)-(g).

<sup>32</sup> The proposed rules define the primary market for purposes of BeX as the listing market for a security, unless otherwise designated by the appropriate BSE Board committee; provided, however, that if a security is traded by the New York Stock Exchange, Inc. (“NYSE”), then the primary market for such security would be the NYSE, and if a security is not traded by the NYSE and is traded by the Amex, then the primary market for such security would be the Amex. If a security is traded on both the NYSE and the Amex, whichever of the two is the listing market would be considered the primary market. If a security is solely listed on any other exchange, then the primary security for that market would be that exchange. See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (a)(i). Nasdaq securities and BSE-solely listed issues, which currently are assigned to a specialist, would continue to trade under the BSE’s existing rules, and not on BeX.



or better than the BeX opening price would be paired for execution at that price following applicable BeX priority rules.

Where the Opening is based on a quote in the primary market, the BeX would open in one of the following ways: (1) where there were orders in the BeX that could not be matched, the BeX would open on a quote; (2) where there were orders in the BeX that could be matched, the BeX opening price would be the Theoretical Opening Price (“TOP”),<sup>33</sup> provided the TOP is at or within the National Best Bid and Offer. If the only orders in BeX at the opening are Market Orders, the TOP will be the prior day’s closing price and the orders would be executed at that price. If that price is not within the National Best Bid or Offer, the order would be routed, at the instruction of the Member entering the order, to the market center(s) displaying the National Best Bid or Offer. If the Member has not provided the instruction to route, the order will be cancelled; (3) where there were orders in the BeX that could be matched, and the TOP is not at or within the National Best Bid and Offer, the BeX opening trade price would be at the National Best Bid or Offer closest to the TOP as long as orders could be matched at that price. If orders could not be matched at that price, the BeX would open on a quote.

Following the opening execution process in an individual security all orders remaining that are executable against the National Best Bid and Offer would be cancelled, or routed in accordance with the customer’s instruction. All other orders would be booked on the BeX.

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<sup>33</sup> The TOP would be the price that maximizes the quantity of orders traded on the BeX at the opening. If there are multiple prices that maximize the quantity of orders traded on the BeX at the opening, then the TOP would be the price that minimizes the quantity of orders not traded. If there are multiple prices that minimize the quantity of orders not traded, then the price that minimizes any order imbalance is the TOP. If there are multiple prices that minimize the quantity of orders not traded and there is no order imbalance, the TOP is the price closest to the previous day's closing price. See proposed BSE Rule, Chapter XXXVII, Section 3(c)(iii).

Immediately following the Opening for individual securities, BeX will commence the Primary Trading Session. All orders would be matched automatically following price and time priority as soon as they are entered in the BeX book. Incoming orders would be executed at or within the National Best Bid and Offer.

BeX would close the Primary Trading Session in the following manner: beginning at 3:40 p.m., BeX would broadcast the imbalance between the At-the-Close and Limit-or-Close orders on the bid side, and At-the-Close and Limit-or-Close orders on the offer side. During this “Market on Close Period,” At-the-Close and Limit-or-Close orders could not be cancelled. At 4:00 p.m., BeX would put all eligible orders in such securities received by 4:00 p.m. into an Authorized Reserve State. When BeX received the closing price message from the primary market, the BeX trading engine would complete the closing process for each individual security. During this process, all paired At the Close and Limit or Close orders would be executed at the primary market closing price.

The Post-Primary Trading Session would operate from the time when the primary market disseminates its closing price until 4:30. During the Post Primary Trading Session only Post Primary Cross orders at a specific price could be submitted.

**Cancellations of transactions and handling of clearly erroneous transactions.**

Under the proposed rules, Members that make a transaction in demonstrable error could agree to cancel and unwind the transaction, subject to the approval of the Exchange.<sup>34</sup> For purposes of the BeX facility, the Exchange also proposes to adopt procedures for review of clearly erroneous transactions when such review is requested.<sup>35</sup> The Chief Regulatory Officer (“CRO”) or another officer designated by the CRO would review the transaction and potentially

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<sup>34</sup> See proposed BSE Rule, Chapter XXXVII, Section 4, Paragraph (a).

<sup>35</sup> See proposed BSE Rule, Chapter XXXVII, Section 5, Paragraph (a).

modify or cancel executions where one party believes that the terms of the transaction were clearly erroneous when submitted. The CRO or another officer designated by the CRO would also be able to modify or cancel executions that result from a disruption or malfunction in the use or operation of BeX, or any communications system associated with the BeX.

The proposed rules set out procedures for each of these reviews, including specific means for Members to appeal the Exchange's decisions.

**Adjustment of orders on ex-dates.** The Exchange also proposes to adopt a process for adjusting orders in securities quoted ex-dividend, ex-distribution, ex-rights, or ex-interest.

### **III. Discussion**

After careful review of the proposal, the Commission finds that the proposed rule change, as amended, which would establish trading rules for the BeX facility, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>36</sup> In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,<sup>37</sup> which requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest.

According to BSE, it currently has no provisions for the trading of securities that are not assigned to a specialist. Under the proposed rule change, BSE would inaugurate a new, fully-electronic facility for the trading of equity securities, which would permit orders in eligible securities to match against each other automatically, without the participation of a BSE

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<sup>36</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>37</sup> 15 U.S.C. 78f(b)(5).

specialist. The Commission finds that the proposed rules governing the BeX facility are designed to perfect the mechanism of a free and open market by providing for the automatic handling of orders in BeX-eligible securities in a fair and reasonable manner. In the Commission's view, this new automatic execution facility should help provide investors with a more efficient mechanism by which to immediately access and trade securities on the Exchange.<sup>38</sup>

Various facets of the proposed rule change are discussed below.

### **1. Eligible Securities**

Under the proposed rule change, securities eligible for trading on BeX would include all securities eligible for trading on the Exchange that are not listed on the Nasdaq for which the BSE obtains UTP after June 30, 2006. Although, under the proposal, a specialist could request to remove a security from BeX, the Commission notes that a security would not be eligible for trading on BeX if that same security is traded by a BSE specialist. The Commission further notes that, since filing the instant proposal, the Exchange has filed a proposed rule change that is intended to eliminate, as of January 1, 2007, specialist participation in any transactions on the BSE.<sup>39</sup> The Commission believes that the Exchange's retention on a short-term basis of its existing specialist system for securities that have traded pursuant to UTP on the BSE prior to June 1, 2006, at the same time BeX is introduced for other securities, is a reasonable approach by

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<sup>38</sup> The Commission notes that the Exchange recently filed a proposed rule change, that, among other things, would add enhancements to the BeX facility to ensure the Exchange's compliance with Regulation NMS under the Act, and to qualify as an "automated trading center" under that regulation. While the Commission believes that the instant proposed rule change, as amended, is consistent with the requirements of the Act, the Commission is not making a determination in this Order that the Exchange's automatic execution capabilities would satisfy the "automated trading center" definition in Rule 600(b)(4) of Regulation NMS.

<sup>39</sup> See BeX Phase II Notice, supra note 10.

which the Exchange can phase-in its fully-automated trading system.

## **2. Receipt, Ranking, Display, and Automated Matching of Orders**

Orders could be routed to BeX through the Exchange's systems or through other communications lines approved by the Exchange for the delivery of orders by Exchange Members.<sup>40</sup> BeX would also accept and automatically execute commitments sent by market centers that participate in ITS.

Under the proposed rule change, all orders sent to BeX (excluding the order types discussed below) would be ranked according to their price and time of receipt and would be displayed to the public when they constitute the Best Bid or Offer in BeX for a security. No distinction is made to this priority with regard to agency orders and professional or proprietary orders. The Commission believes that the use of price/time priority in the ranking, display, and matching of orders, and the equal treatment of agency and professional orders, is consistent with the Act. The Commission notes that it previously has approved similar rules for other exchanges.<sup>41</sup>

## **3. Eligible Order Types**

In addition to accepting specific order types set forth in BSE's existing rules, the Exchange proposes to add several new order types for use exclusively on BeX. These order types include Cross, Cross with Size, Good 'Till Date, Good 'Till Time, Limit or Close, Mid-Point Cross, and Post Primary Cross orders types. The Commission believes that these new order types are appropriate in the context of the BeX facility. In addition, they should help provide market participants with greater flexibility in fulfilling their trading objectives.

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<sup>40</sup> See proposed BSE Rule, Chapter XXXVII, Section 3, Paragraph (h)(i).

<sup>41</sup> See, e.g., Securities Exchange Act Release No. 52094 (July 21, 2005), 70 FR 43913 (July 29, 2005) (Order approving the electronic book for the Chicago Stock Exchange, Inc.).

With respect to the Cross, Cross with Size, and Mid-point Cross orders that would be implemented in BeX, the Commission notes that similar order types have been approved for electronic trading systems at other exchanges.<sup>42</sup> The Commission notes that the proposed rule regarding Cross with Size, in consonance with the criteria for larger-sized crosses contained in the existing BSE rules, would require this order type to be for at least 5,000 shares and larger than the aggregate size of all interest displayed in BeX at the price of the cross. It would further require that neither side of the order be for the account of the BSE member sending the order to the Exchange. The Exchange has added another condition for BeX, stipulating that the order must have a market value of at least \$100,000.<sup>43</sup>

#### **4. Compliance with Intermarket Trading System Plan**

The Commission believes that the proposed rule change includes provisions serving to ensure that the BeX complies with the ITS Plan and thereby promote the fair and orderly operation of the national market system.<sup>44</sup> In this regard, the Commission notes that the rules provide that if an order in an ITS-eligible security crosses or locks the NBBO at the time that it is received, the order would be cancelled or, at the instruction of the member entering the order, routed to the market center(s) displaying the National Best Bid or Offer.

If an incoming Limit Order or Market Order in an ITS-eligible security would trade through (as defined in the ITS Plan) the NBBO if executed on the BeX at the time of receipt, it would either be cancelled, or routed to the market(s) displaying the NBBO if it contains such instruction from the Exchange member entering the order. Inbound ITS commitments, if priced

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<sup>42</sup> See Chicago Stock Exchange Rules Chapter XXA, Rule 2(c)(3)-(4); NYSE Arca Rule 7.31(y).

<sup>43</sup> The Commission notes that the BSE has proposed to amend the Cross with Size provision as part of the second phase of BeX. See BeX Phase II Notice.

<sup>44</sup> See also supra note 26.

at or better than the current best bid or offer in BeX (“BBO”), would be automatically executed against the order(s) reflected in the BBO for the full amount of shares at that price, and any remaining portion of the ITS commitment would be automatically cancelled.

## **5. Trading Sessions and Opening and Closing Procedures**

The BeX will open its Primary Session for trading each day, and begin processing orders that have been submitted during the 7:30 to 9:30 a.m. Pre-Opening Session, once the primary market for the relevant security opens. When the primary market opens on a trade print, the opening price on BeX will match the price of that transaction. When the primary market opens on a displayed quote, and there are no orders in BeX that can be matched, BeX also will open on a quote. When there are orders that can be matched, the opening price will be either the TOP, or – when the TOP is inferior to the National Best Bid or National Best Offer – at the closer of the National Best Bid or National Best Offer to the TOP, if there are orders on the BeX that can be matched at that price. Otherwise, BeX will open on a quote. Following the opening in an individual security – where there were orders that were matched – any remaining orders that could be executed at the NBBO are either canceled, or routed in accordance with the customer’s instructions. Remaining orders that could set a new NBBO would be displayed. All other orders would be placed on the BeX book.

To close the Primary Trading Session, at 3:40 p.m., BeX would broadcast the imbalance between the orders on the bid and ask side, respectively, that have been designated to be executed at the closing price (i.e., At-the-Close and any Limit-or-Close orders that have not been executed by this time, and have therefore been converted to At the Close orders). At 4:00 p.m., BeX would put all eligible orders in such securities received by 4:00 p.m. into an Authorized Reserve State. When BeX receives the closing price message from the primary market, BeX

would complete the closing process for each individual security by pairing these orders and executing them at the primary market closing price. From this time until 4:30 p.m., the BeX will operate a Post-Primary Trading Session during which only Post Primary cross orders could be submitted. The Commission believes that the proposed BeX opening and closing procedures are reasonable and consistent with the Act.

## **6. Cancellations, Clearly Erroneous Transactions, and Adjustment of Orders**

The Exchange's proposal would allow participants making a demonstrable error to agree to cancel and unwind the transaction, subject to the Exchange's approval. The proposed rule change also sets forth formal procedures regarding the Exchange's review of clearly erroneous transactions, and the specific means for market participants to appeal decisions made by Exchange officials. The Commission believes that these proposed rules are consistent with the Act and should provide for a fair, transparent, and reasonable process in which BeX participants can correct erroneous transactions. The Commission notes that it has approved similar rules at other exchanges.<sup>45</sup>

The proposal also sets forth the rules governing how and when it would adjust certain orders to buy or sell a security when a security is quoted ex-dividend, ex-distribution, or ex-interest. These procedures should help ensure that such orders will continue to be handled according to the sellers' or buyers' original intentions and to preserve the ability of these orders to obtain the best price available. These proposed rules, too, are substantially similar to rules of another exchange that were previously approved by the Commission.<sup>46</sup>

## **7. Application of "Effect v. Execute" Exemption from Section 11(a) of the Act**

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<sup>45</sup> See, e.g., CHX Rules, Article XXA, Rules 5 and 7; NYSE Arca Rule 7.10.

<sup>46</sup> See NYSE Rule 118.



Section 11(a) of the Act<sup>47</sup> prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion (collectively, “covered accounts”) unless an exception applies. Rule 11a2-2(T)<sup>48</sup> under the Act, known as the “effect versus execute” rule, provides exchange members with an exemption from the Section 11(a) prohibition. Rule 11a2-2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with Rule 11a2-2(T)’s conditions, a member (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution; (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in the connection with effecting the transaction except as provided in the Rule.

In letters to the Commission,<sup>49</sup> the Exchange represented that transactions effected in the BeX trading system meet the requirements of Rule 11a2-2(T). Based on these representations, the Commission finds that the BeX trading system satisfies the four conditions of Rule 11a2-2(T).

First, orders would be sent, by electronic means, to the physically separate trading platform of BeX. In the context of other automated trading systems, the Commission has found

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<sup>47</sup> 15 U.S.C. 78k(a).

<sup>48</sup> 17 CFR 240.11a2-2(T).

<sup>49</sup> See Letter from Letter from William C. Meehan, General Counsel, BSE, to Kelly M. Riley, Assistant Director, Division of Market Regulation, Commission, dated June 2, 2006; see also Letter from William C. Meehan, General Counsel, BSE, to Kelly M. Riley, Assistant Director, Division, Commission, dated August 8, 2006.

that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.<sup>50</sup> The Exchange stated in its letter that it proposes that its members, whether they are located on the Exchange's physical trading floor or off of the floor, be able to use automated means to transmit orders for their own account into the BeX trading system. The Commission has stated that the off-floor transmission requirement may be met when an order is sent from one trading floor of an exchange to another, separate trading floor of the same exchange.<sup>51</sup> On the basis of the Exchange's representations, the Commission believes that orders sent, by electronic means, from the Exchange's physical trading floor may be considered to be sent from "off-floor" for purposes of the BeX trading

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<sup>50</sup> See, e.g., Securities Exchange Act Release Nos. 49066 (January 13, 2004), 69 FR 2773 (January 20, 2004) (order approving the Boston Options Exchange as an options trading facility of the Boston Stock Exchange); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (regarding New York Stock Exchange's ("NYSE") Off-Hours Trading Facility); 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) (regarding the American Stock Exchange ("Amex") Post Execution Reporting System, the Amex Switching System, the Intermarket Trading System, the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange, the Pacific Exchange's ("PCX") Communications and Execution System, and the Philadelphia Stock Exchange's ("Phlx") Automated Communications and Execution System ("1979 Release")); and 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (regarding the NYSE's Designated Order Turnaround System). See also Letter from Paula R. Jensen, Deputy Chief Counsel, Division, Commission, to Angelo Evangelou, Senior Attorney, Chicago Board Options Exchange ("CBOE"), dated March 31, 2003 (regarding CBOE's CBOEdirect system ("CBOEdirect Letter")); Letter from Paula R. Jensen, Deputy Chief Counsel, Division, Commission, to Jeffrey P. Burns, Assistant General Counsel, Amex, dated July 9, 2002 (regarding Amex's Auto-Ex system for options); Letter from Paula R. Jensen, Deputy Chief Counsel, Division, Commission, to Richard S. Rudolph, Counsel, Phlx, dated April 15, 2002 (regarding Phlx's AUTOM System and its automatic execution feature AUTO-X); Letter from Paula R. Jensen, Deputy Chief Counsel, Division, Commission, to Kathryn L. Beck, Senior Vice President, Special Counsel and Antitrust Compliance Officer, PCX, dated October 25, 2001 (regarding Archipelago Exchange ("ArcaEx") ("ArcaEx Letter")); Letter from Brandon Becker, Director, Division, Commission, to George T. Simon, Foley & Lardner, dated November 30, 1994 (regarding Chicago Match ("Chicago Match Letter")).

<sup>51</sup> See Letter from Richard A. Steinwurtzel, Attorney, Office of Chief Counsel, Division, Commission, to Philip J. Lo Bue, Senior Vice President, PCX, dated December 22, 1978); see also Securities Exchange Act Release No. 52094 (July 21, 2005), 70 FR 43913 (July 29, 2005) (order approving the Chicago Stock Exchange, Inc. Ebook).

system. Specifically, the Commission believes that because the securities traded on the BeX trading system are not traded on the Exchange's physical floor, the BeX trading system is essentially a different, separate "trading floor." The Commission notes that Exchange floor members will not have a time/place advantage with regard to the securities traded in the BeX trading system. Specifically, orders transmitted from the Exchange's trading floor will not be processed any more quickly by the BeX trading system than those orders received from off the physical floor. In addition, floor members will see information about orders that are at the top of the BeX trading system only after that information has been sent to the securities information processor for dissemination to the public. Thus, based on these facts, the Commission believes the off-floor transmission requirement is satisfied in this case.

Second, the rule requires that the member not participate in the execution of its order. The Exchange represented that its members relinquish control of orders after they are submitted to BeX and noted that the members do not receive any special or unique trading advantages in BeX.<sup>52</sup> Third, although Rule 11a2-2(T) contemplates having an order executed by an exchange member who is unaffiliated with the member initiating the order, the Commission recognizes that the requirement may be satisfied when automated exchange facilities are used.<sup>53</sup> Finally, the

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<sup>52</sup> See Securities Exchange Act Release No. 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (Order approving ArcaEx as the equities trading facility of PCX Equities Inc.); 1979 Release, supra note 50. See also CBOEdirect Letter, supra note 50; Letter from Larry E. Bergmann, Senior Associate Director, Division, Commission, to Edith Hallahan, Associate General Counsel, Phlx, dated March 24, 1999 (regarding Phlx's VWAP Trading System); Letter from Catherine McGuire, Chief Counsel, Division, Commission, to David E. Rosedahl, PCX, dated November 30, 1998 (regarding Optimark); and Chicago Match Letter, supra note 50.

<sup>53</sup> In considering the operation of automated execution systems operated by an exchange, the Commission noted that while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted into the systems. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the

BSE represents that members that rely on Rule 11a2-2(T) for a managed account transaction must comply with the limitations on compensation set forth in the rule.

### **Accelerated Approval of Amendment No. 5**

The Commission finds good cause for approving Amendment No. 5 to the proposed rule change prior to the thirtieth day after publishing notice of Amendment No. 5 in the Federal Register pursuant to Section 19(b)(2) of the Act.<sup>54</sup>

In Amendment No. 5, the BSE amended Chapter II, Section 41 - Minimum Price Variation to state that the Exchange shall not display, rank, or accept any bids, offers, or orders in a security priced in an increment smaller than \$0.01 if that bid, offer, or order is priced equal to or greater than \$1.00, but that the Exchange may execute and report Mid-point Cross Orders in increments as small as one-half the Minimum Price Variation for the security. In addition, BSE amended the rules text of BSE Rule, Chapter XXXVII to clarify that if an At the Close order is not fully executed at the close, the part of the order not executed will be cancelled; to clarify opening procedures; to indicate more clearly when orders would be routed at the instruction of the member entering the order, to the market center(s) displaying the National Best Bid or Offer; and to clarify how cross orders would be executed in the Post-Primary Trading Session. The Exchange also corrected several technical errors contained in the rule text.

The Commission believes that these clarifying and technical changes to the proposed rule change improve the proposal and raise no new or novel issues of regulatory concern, and

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exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See 1979 Release, supra note 50.

<sup>54</sup> 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

therefore should not delay its implementation. Accordingly, the Commission finds good cause to accelerate approval of Amendment No. 5, pursuant to Section 19(b)(2) of the Act.<sup>55</sup>

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 5, including whether Amendment No. 5 is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BSE-2006-22 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BSE-2006-22. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of

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<sup>55</sup> 15 U.S.C. 78s(b)(2).

such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to Amendment No. 5 of File Number SR-BSE-2006-22 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

**V. Conclusion**

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5) of the Act.<sup>56</sup>

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>57</sup> that the proposed rule change (SR-BSE-2006-22), as amended, and Amendment No. 3 thereto, is approved and Amendment No. 5 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>58</sup>

Nancy M. Morris  
Secretary

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<sup>56</sup> 15 U.S.C. 78f(b)(5).

<sup>57</sup> 15 U.S.C. 78s(b)(2).

<sup>58</sup> 17 CFR 200.30-3(a)(12).