

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61797; File No. SR-BX-2010-009)

March 29, 2010

Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Order Approving Proposed Rule Change, as Modified by Amendments No. 1 and 3 Thereto, Relating to the Directed Order Process on the Boston Options Exchange Facility

I. Introduction

On January 25, 2010, NASDAQ OMX BX, Inc. (“Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change amending the rules of the Boston Options Exchange Group, LLC (“BOX”) to modify the Directed Order process on BOX. The Exchange filed Amendment No. 1. to the proposed rule change on February 10, 2010. The proposed rule change, as modified by Amendment No. 1, was published in the Federal Register on February 24, 2010.³ On March 22, 2010, the Exchange filed Partial Amendment No. 2 (“Amendment No. 2”) to the proposed rule change, and on March 24, 2010, the Exchange filed Partial Amendment No. 3 (“Amendment No. 3”) to the proposed rule change.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as modified by Amendments No. 1 and 3.

II. Description of the Proposal

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 61531 (February 17, 2010), 75 FR 8416 (hereinafter referred to as “Notice”).

⁴ Amendment No. 3 replaced and superseded Amendment No. 2 in its entirety. In Amendment No. 3, the Exchange made conforming changes to its rule text to reflect a recently approved proposed rule change. See Securities Exchange Act Release No. 61577 (February 24, 2010), 75 FR 9496 (March 2, 2010) (SR-BX-2010-017). This

The Exchange is proposing modifications to the Directed Order process on BOX.⁵ Specifically, the Exchange is proposing to automate the creation of the Guaranteed Directed Order (“GDO”) and the manner in which the quote of an Executing Participant (“EP”)⁶ is handled during the Directed Order process.

A. Quote Shelving and GDO

Currently, upon receipt of a Directed Order an EP must either submit the Directed Order to the PIP⁷ or send the Directed Order to the BOX Book. When the EP sends the Directed Order to the BOX Book and the EP’s quotation on the opposite side of the market from the Directed Order is equal to the National Best Bid or Offer (“NBBO”) and the Directed Order is also executable against the NBBO, the EP must guarantee execution of the Directed Order at the current NBBO for at least the size of his quote. This guarantee is called the GDO. Under the current rule, the EP must immediately send the Directed Order with the GDO to the Trading Host. Sending the GDO to the Trading Host enables it to simultaneously take down or “shelve” the EP’s quote and any pending quote updates while the Directed Order is being exposed on the BOX Book.

Under the proposal, if the Directed Order is executable against the current NBBO and the EP is also quoting at such NBBO on the opposite side of the Directed Order, the GDO will be

technical amendment does not require notice and comment as it did not materially affect the substance of the rule filing.

⁵ See Chapter VI, Section 5(c). A Directed Order is any Customer Order to buy or sell which has been directed to a particular Market Maker by an OFF. See Chapter I, Section 1(a)(21) of the BOX Rules. Terms not otherwise defined herein shall have the meaning assigned to them in the BOX Rules.

⁶ When a BOX Market Maker indicates its interest in receiving Directed Orders, the receiving Market Maker is referred to as the EP.

⁷ See Chapter V, Section 18 of the BOX Rules.

automatically created by the Trading Host and the EP's quote will be automatically shelved. In addition, the GDO creation and the quote shelving will be moved to an earlier point in the Directed Order process. Where presently they occur only when the Directed Order is sent to the BOX Book by the EP, they will now take place immediately upon the Trading Host's receipt of the Directed Order from the submitting order flow provider ("OFP").⁸

Once the GDO has been generated by the Trading Host, the EP will systemically be prohibited from posting a quotation. The EP's pending quote that was taken down by the Trading Host will not be released until: (i) the Directed Order is modified by the submitting OFP; (ii) the EP sends the Directed Order to the PIP; or (iii) the EP submits the Directed Order to the BOX Book, and either one of the following occurs: (a) the Directed Order trades in full; (b) the Directed Order exposition ends; or (c) the Directed Order is modified or cancelled by the submitting OFP during such exposition.

Under the proposal, if the Directed Order is modified by the submitting OFP once the Trading Host has automatically established the GDO, then the modified Directed Order shall no longer be considered a Directed Order and shall be immediately released to the BOX Book and treated as a regular order.⁹ If no GDO had been established, then the modified Directed Order

⁸ The proposal clarifies that if a GDO has been automatically generated and is pending, then upon receipt by the Trading Host of a subsequent Directed Order for the same EP for the same series and side of the market, such subsequent order will not be considered a Directed Order but will be treated as a regular order. The Trading Host will not send the order to the EP, but will immediately release it to the BOX Book as a regular order. If no GDO has been automatically generated, then such subsequent order will be sent to the EP and treated as a new Directed Order. See electronic mail from Wayne Pestone, Chief Legal Officer, BOX, to Heather Seidel, Terri Evans and Sarah Schandler, Division of Trading and Markets, Commission, dated February 3, 2010 (confirming that the Directed Order process currently functions in this manner on BOX).

⁹ Upon modification or cancellation of the Directed Order, the Trading Host will immediately reestablish the EP's quote, including any of the EP's pending quote

shall be resubmitted to the EP. The proposal provides that it shall be considered by the Exchange to be conduct inconsistent with just and equitable principles of trade for any Options Participant or person to communicate with an EP about the terms or conditions of a Directed Order prior to its outcome in the BOX Trading Host (e.g. execution, cancellation).

Under the proposal, the EP's obligations when using the PIP remain the same as under the current rule, however in some instances the obligation will be met automatically by the Trading Host. For example, if a GDO has been automatically generated, then the Trading Host will prohibit the EP from adjusting his quotation prior to submitting the Directed Order to the PIP process. Moreover, upon submission of the Directed Order to the PIP, the Trading Host will only accept a Primary Improvement Order priced at or better than (i) the GDO or (ii) the NBBO at the time the EP sent the Directed Order to the PIP, whichever is better for the Directed/PIP Order.

The Exchange proposes to add certain details and clarifications to the rule regarding the treatment of Directed Orders that have been released to the BOX Book for exposure when a GDO has been automatically generated. The proposal clarifies that when the EP does not PIP the Directed Order and releases it to the BOX Book, if a GDO has been automatically generated and the Directed Order is not executable against the current NBBO, then the Trading Host will expose the order at the better GDO price for three (3) seconds.¹⁰ Under the proposal, if a GDO has been automatically generated and the Directed Order is executable against the current NBBO, the Directed Order will immediately execute against the BOX Book if the BOX Best Bid

modifications, with a new time priority; or in the case of a pending quote cancellation, the EP's quote will be cancelled.

¹⁰ See electronic mail from Wayne Pestone, Chief Legal Officer, BOX, to Heather Seidel, Terri Evans and Sarah Schandler, Division of Trading and Markets, Commission, dated

or Offer is equal to or better than the NBBO and GDO. Any remaining quantity not executed will immediately be exposed to BOX Participants at the better of the NBBO or GDO price. As is the case under the current rule, this exposure period will last three (3) seconds, during which time any Options Participant, except for the EP, may submit an order to the BOX Book in response, and any orders submitted to the BOX Book during this period will execute immediately against any remaining quantity of the Directed Order, in time priority. Also as is the case under the current rule, after exposure of the Directed Order for three (3) seconds, the Trading Host will release the GDO, where it will be able to execute against any remaining quantity of the Directed Order.

During the exposure period, the EP may not decrement the size, worsen the price of his GDO or submit a contra order. Because the Trading Host will now automatically create the GDO and shelve the EP's quote, it will not process such changes to the GDO or pending quote, except a decrementation of the GDO size down to the size of the remaining Directed Order after execution with the BOX Book. The EP may increase the size of his GDO, the same as today. Under the proposal the EP also may better the price of his GDO or modify his pending quote to be reestablished, but the Trading Host will not apply such modification until the quote is reestablished. Following execution of the Directed Order, the Trading Host will reestablish the quote of the EP with a new time priority, decremented by any executed portion of the GDO or as modified by the EP.

The Exchange also proposes to make several additional changes to the text of Chapter VI, Section 5(c). The Exchange proposes to change several references to "Market Maker" to "EP" to more closely align the rule text with the terminology used to describe the Directed Order process.

February 3, 2010 (confirming that the Directed Order process currently functions in this manner on BOX).

In addition, the Exchange proposes to add the word “current” before certain instances of the term “NBBO” in order to clarify which NBBO is being referenced at a particular stage in the Directed Order process. The Exchange also is proposing to remove from Section 5(c)(iii)(1) certain language about the function of the NBBO filter process pursuant to Chapter V, Section 16(b), which the Exchange views as unnecessary and duplicative.

B. Market Maker Quoting Obligations

The Exchange proposes to add new Supplementary Material .02 to Chapter VI, Section 5(c)(ii). The proposed Supplementary Material .02 states that when a Market Maker’s quote is shelved while acting as EP, such time without posting a quote will not count towards fulfilling his obligations for purposes of the Market Maker’s quoting obligations under Chapter VI, Section 6(d) of the BOX Rules.

C. Implementation

The Exchange has represented that after Commission approval and at least one week prior to implementation of the rule change, Boston Options Exchange Regulation LLC will issue a regulatory circular to all Participants that will inform Participants of the implementation date and will give Participants an opportunity to make any necessary modifications to coincide with the implementation date.

III. Discussion and Commission’s Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,¹¹ which requires, among other things, that the rules of an exchange

¹¹ 15 U.S.C. 78f(b)(5).

are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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.¹²

As noted above, BOX Rules currently provide that if an EP is at the NBBO and the Directed Order is marketable, the EP must guarantee execution of that order at the NBBO for at least the size of his quote. Under the current rule, the EP is responsible for submitting a GDO to the Trading Host. Pursuant to the proposed rule change, the Exchange is proposing to automate the GDO process. The Commission believes that automating the GDO process, including “shelving” the EP’s quote, should help ensure that GDOs are generated in compliance with BOX rules. Further, the Commission believes that automating the creation of the GDO by the Trading Host will aid Market Makers in complying with the BOX rules regarding Directed Orders.

The Exchange has proposed the addition of language to the rule text to describe the treatment of a Directed Order when the Directed Order is subsequently modified or cancelled, depending upon whether a GDO has been automatically generated. The Commission believes that the Exchange’s proposed treatment of modified or cancelled Directed Orders is consistent with the Act. As discussed above, the Exchange has proposed that it would be conduct inconsistent with just and equitable principles of trade for any Options Participant or person to communicate with an EP about the terms or conditions of a Directed Order prior to its outcome in the BOX Trading Host. Moreover, when a Directed Order is modified or cancelled after a

¹² 15 U.S.C. 78f(b)(4). In approving the proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition and capital formation. See 15 U.S.C. 78c(f).

GDO has been automatically generated, the EP's quote will be reestablished with a new time priority. The Commission believes that these provisions should ensure that Directed Orders are not modified or cancelled in a manner that would be inconsistent with the Act.

As set forth above, the Exchange has proposed the addition of language to the rule text to describe what occurs on BOX when a GDO has been automatically generated and is pending and the Trading Host receives a subsequent Directed Order for the same EP. The Exchange has also proposed the addition of language to the rule text to clarify the treatment of Directed Orders that have been released to the Box Book for exposure after a GDO has been automatically generated. The Exchange has represented that the processes described by this additional and clarifying language are currently a part of the Directed Order process on BOX although not specifically set forth in the current rule text. The Exchange also proposes to make several non-substantive changes in the text of Chapter VI, Section 5(c) to more closely align the rule text with the terminology used to describe the Directed Order process and to remove duplicative language. The Commission believes that these changes and additions, which will provide greater clarity throughout the Directed Order process for Market Makers, OFPs and other Participants on BOX and will more closely align the rule text with the Directed Order process as it occurs on BOX, are consistent with the Act.

The Commission also believes that the Exchange's proposed addition of Supplementary Material .02, clarifying that the time that a Market Maker's quote is shelved does not count towards fulfilling his quoting obligations under Chapter VI, Section 6(d) of the BOX Rules, is appropriate and consistent with the Act. The Commission notes that Market Makers are subject to quoting requirements under Chapter VI, Section 6(d). Specifically, Market Makers are required on a daily basis to post quotes at least 80 percent of the time an options class is open for

trading in 90 percent of their appointed classes. Furthermore, Market Makers must post valid quotations at least 60 percent of the time in each of their appointed classes during the time that the class is open for trading. Accordingly, the Commission believes that it is appropriate for the Exchange to exclude the time a Market Maker's quote is shelved under the Directed Order process in determining whether a Market Maker has satisfied his quoting obligations as no quote will be posted by the Market Maker during such time the quote is shelved.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-BX-2010-009), as modified by Amendments No. 1 and 3 thereto, be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Florence E. Harmon
Deputy Secretary

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).