

in paragraph (b) of Rule 17a-7, and (2) the net asset value per share of each portfolio involved valued according to the procedures disclosed in its registration statement and as required by Rule 22c-1 under the Act. The Section 17(b) Applicants state that if Sun Capital declines to accept particular portfolio securities of either of the Old Portfolios for purchase in-kind of shares of a New Portfolio, the applicable Old Portfolio will liquidate portfolio securities as necessary and shares of the New Portfolios will be purchased with cash. Consistent with Rule 17a-7(d), Applicants also agree that no brokerage commissions, fees, or other remuneration will be paid in connection with the in-kind transactions.

### Conclusions

1. Applicants submit that for the reasons and upon the facts set forth in their application, the requested order pursuant to Section 26(c) of the Act is consistent with the protection of investors and the purposes fairly intended by the policy of the Contracts and provisions of the Act and should, therefore, be granted.

2. Section 17 Applicants represent that the proposed in-kind transactions are consistent with the general purposes of the Act, do not present any of the conditions or abuses the Act was designed to prevent, and that an exemption should be granted, to the extent necessary, from the provisions of Section 17(a).

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

**Florence E. Harmon,**

*Acting Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-59154; File No. SR-BSE-2008-48]

### Self-Regulatory Organizations; Boston Stock Exchange, Incorporated; Order Approving a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, To Establish New Rules for Membership, Member Conduct, and the Listing and Trading of Cash Equity Securities; Order Granting an Exemption for the Boston Stock Exchange, Incorporated From Section 11A(b) of the Securities Exchange Act of 1934

December 23, 2008.

#### I. Introduction

On November 3, 2008, the Boston Stock Exchange (“BSE” or “Exchange”), filed with 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: (i) Adopt new rules governing membership, the regulatory obligations of members, listing, and equity trading (“Equity Rules”); (ii) amend its certificate of incorporation (“Certificate”) and by-laws (“By-laws”) to reflect the proposed change in the name of the Exchange to NASDAQ OMX BX, Inc; (iii) amend and restate the Operating Agreement of BSX Group LLC (“Operating Agreement”), which will operate the Exchange’s cash equities trading business, and which will be renamed NASDAQ OMX BX Equities LLC (“BX Equities LLC”); and (iv) to adopt a Delegation Agreement (“Delegation Agreement”) between the Exchange and BX Equities LLC (formerly, BSX Group LLC). The proposed rule change was published for comment in the **Federal Register** on November 19, 2008.<sup>3</sup> On November 12, 2008, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>4</sup> On December 23, 2008, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>5</sup> Because Amendment Nos. 1

and 2 make technical modifications to the original rule proposal, the Commission is not publishing them for comment. The Commission received no comment letters regarding the proposed rule change. This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2.

On December 23, 2008, the Exchange requested that the Commission grant BX Equities LLC a permanent exemption from the requirement under Section 11A(b) of the Act, and Rule 609 thereunder, that a securities information processor (“SIP”) acting as an exclusive processor register with the Commission.<sup>6</sup> This order grants the requested exemption.

#### II. Background

On August 7, 2008, the Commission approved, along with related proposals, a BSE proposed rule change relating to governing documents and certain rules of the Exchange to accommodate the acquisition of the Exchange by The NASDAQ OMX Group, Inc. (“NASDAQ OMX”), the parent corporation of Nasdaq.<sup>7</sup> Among other things, the BSE Approval Order: (i) Amended and restated BSE’s Certificate to reflect the Exchange’s status as a wholly owned subsidiary of NASDAQ OMX; (ii) established new By-laws that are similar to the by-laws of Nasdaq; (iii) amended the Operating Agreement of BSX Group LLC, the entity that operated the Exchange’s cash equities trading business prior to the Exchange’s acquisition by NASDAQ OMX;<sup>8</sup> (iv) prohibited an Exchange member or its associated persons from beneficially owning more than 20% of the outstanding voting securities of NASDAQ OMX; and (v) limited the circumstances under which the Exchange may be affiliated with a member, and approved the affiliation

regulatory purposes; and (2) the proposal to accept orders routed by Nasdaq Execution Services, LLC (“NES”) to the Exchange on a one-year pilot basis is made by the Exchange, rather than by The NASDAQ Stock Market, LLC (“Nasdaq”).

<sup>6</sup> See letter from John Zecca, Chief Regulatory Officer, Exchange, to Dr. Erik Sirri, Director, Division of Trading and Markets, Commission, dated December 23, 2008 (“SIP Exemption Request Letter”). See also 15 U.S.C. 78k-1(b), Rule 609 under the Act, 17 CFR 242.609, requires that the registration of a securities information processor be on Form SIP, 17 CFR 249.1001.

<sup>7</sup> See Securities Exchange Act Release No. 58324, 73 FR 46936 (August 12, 2008) (SR-BSE-2008-02; SR-BSE-2008-23; SR-BSE-2008-25; SR-BSECC-2008-01) (“BSE Approval Order”).

<sup>8</sup> BSX Group LLC was formed in 2004 as a joint venture between BSE and several investors to operate an electronic trading facility, the Boston Equities Exchange (“BeX”), for the trading of cash equity securities. BeX ceased its operations in September 2007. See Securities Exchange Act Release No. 57757 (May 1, 2008), 73 FR 26159.

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

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

<sup>3</sup> See Securities Exchange Act Release No. 58927 (November 10, 2008), 73 FR 69685 (“Notice”).

<sup>4</sup> Amendment No. 1 states that the Board of Directors of the Exchange and the Board of Directors of BSX Group LLC have completed all action required to be taken in connection with the proposed rule change.

<sup>5</sup> Amendment No. 2 clarifies that: (1) Confidential information pertaining to the self-regulatory function of the Exchange or any market responsibility delegated by the Exchange to BX Equities LLC that comes into the possession of BX Equities LLC shall not be used for any non-

between the Exchange and certain broker-dealer subsidiaries of NASDAQ OMX that would become members of the Exchange.

On August 29, 2008, the Exchange was acquired by NASDAQ OMX. At the time of this acquisition, the Exchange was not operating a venue for trading cash equities. The Exchange is now proposing to adopt a new rulebook with rules governing membership, the regulatory obligations of members, listing, and equity trading. The proposed new Equity Rules are based to a substantial extent on the rules of Nasdaq. As is the case with Nasdaq, administration and enforcement of many of the rules will be supported by the Financial Industry Regulatory Authority, Inc. ("FINRA") through a regulatory services agreement ("Regulatory Contract"). Other rules, such as listing rules, will be administered by personnel who will be dually employed by the Exchange and Nasdaq, or solely by the Exchange.

The Exchange's existing rules are divided between the rules currently denominated as the "Rules of the Board of Governors" and the "Rules of the Boston Options Exchange Group LLC" ("BOX Rules"). Certain of the Rules of the Board of Governors that are cross-referenced in the BOX Rules ("Grandfathered Rules") will continue to apply to trading on the Exchange's Boston Options Exchange facility ("BOX"). The Grandfathered Rules and the BOX Rules collectively constitute the "Options Rules." The Options Rules, together with the new Equity Rules will constitute the "Rules of the Exchange." Unless an Exchange member is also an "Options Participant," however, it will be subject only to the Equity Rules.<sup>9</sup>

### III. Discussion and Commission Findings

After careful review of the rule proposal, the Commission finds that the

<sup>9</sup> At present, a broker-dealer that is authorized for trading on BOX (an "Options Participant") is not required to become a member of the Exchange, but is nevertheless subject to the Options Rules as if it were a member. Under the revised Rules of the Exchange, this principle will continue to apply. Thus, the Equity Rules will apply to members, which will be authorized to engage in equity trading on the Exchange, and the Options Rules will apply to Options Participants, which will be authorized to engage in options trading. If a member opts to become an Options Participant (or vice versa), it will be subject to both sets of rules. Members must comply with the application requirements of the Option Rules in order to become Options Participants, and conversely, Options Participants must comply with the membership application procedures of the Equity Rules in order to become members and engage in equity trading. See Equity Rules 1013 and 1014; Chapter II of the BOX Rules.

rule proposal is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>10</sup> Specifically, the Commission finds that the proposed rule change is consistent with Section 6(b)(1) of the Act,<sup>11</sup> which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act, and to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and Section 6(b)(2) of the Act,<sup>12</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member, and any person may become associated with a member thereof. Further, the Commission finds that the rule proposal is consistent with Section 6(b)(5) of the Act,<sup>13</sup> which requires, among other things, that the rules of a national securities exchange be 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, and 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. Section 6(b)(5) also requires that the rules of an exchange not be designed to permit unfair discrimination among customers, issuers, brokers, or dealers. In addition, the Commission finds that the proposed rule change is consistent with Section 6(b)(6)<sup>14</sup> and Section 6(b)(7) of the Act,<sup>15</sup> which require, in part, that the rules of an exchange provide a fair procedure for disciplining members and persons associated with members.

Overall, the Commission believes that approving the Exchange's proposed rule change could confer important benefits on the public and market participants. Approval of the proposal would establish the Equity Rules for the operation of an electronic facility for the

trading of cash equity securities.<sup>16</sup> In particular, the entry into the marketplace of a new trading facility would provide market participants with an additional venue for executing orders in cash equity securities, which could enhance innovation and increase competition between and among the equities exchanges, resulting in better prices and executions for investors.

The discussion below does not review every detail of the proposed rule change, but rather focuses on the most significant rules and policy issues considered in review of the proposals.

#### A. Corporate Structure

In the BSE Approval Order, the Commission approved a change in control of BSX Group LLC, the entity that operated BeX as a facility of BSE prior to the Exchange's acquisition by NASDAQ OMX. The Exchange now proposes to change the name of BSX Group LLC to BX Equities LLC and amend the Operating Agreement. The amended Operating Agreement would establish that BX Equities LLC will operate the NASDAQ OMX BX Equities Market ("BX Equities Market") as a cash equities trading facility, as that term is defined in Section 3(a)(2) of the Act,<sup>17</sup> of the Exchange. In addition, the Exchange and BX Equities LLC will enter into a Delegation Agreement, pursuant to which the Exchange will delegate to BX Equities LLC certain limited responsibilities and obligations with respect to the operation of the BX Equities Market as a facility of the Exchange.<sup>18</sup>

#### 1. Ownership and Management of BX Equities LLC

The Operating Agreement will reflect that BX Equities LLC is a closely held subsidiary of the Exchange, whose only owners and members are the Exchange and the Exchange's parent corporation, NASDAQ OMX.<sup>19</sup> Although NASDAQ OMX will maintain a 46.79% ownership interest in BX Equities LLC and the Exchange will maintain a 53.21% ownership interest, the Operating Agreement provides that management of BX Equities LLC will be vested solely in Exchange.<sup>20</sup> The Exchange will be

<sup>16</sup> The Exchange previously operated an electronic trading facility, BeX, for the trading of cash equity securities. BeX ceased its operations in September 2007. See *supra* note 8.

<sup>17</sup> 15 U.S.C. 78(c)(2).

<sup>18</sup> The form of the Delegation Agreement is available at the Commission's Web site <http://www.sec.gov>.

<sup>19</sup> See Section 1.1, Operating Agreement.

<sup>20</sup> In the Notice, the Exchange represented that NASDAQ OMX would remain a member of BX Equities LLC to avoid certain adverse tax

<sup>10</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78f(b)(1).

<sup>12</sup> 15 U.S.C. 78f(b)(2).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 15 U.S.C. 78f(b)(6).

<sup>15</sup> 15 U.S.C. 78f(b)(7).

designated as the sole manager of BX Equities LLC and will have the power to do any and all acts necessary, convenient or incidental to or for the furtherance of the purposes described in the Operating Agreement.<sup>21</sup> As a result, the Exchange will have control over substantially all of the activities of BX Equities LLC.<sup>22</sup>

The Commission believes that the proposal to have the managerial powers vested solely in the Exchange is designed to preserve the Exchange's regulatory authority over BX Equities LLC, and any facility for the trading of cash equity securities that BX Equities LLC operates, and is consistent with the Act because these provisions will grant the Exchange the ability to direct BX Equities LLC to perform any required, necessary, or appropriate act. In particular, the Commission believes that the ownership and management provisions of the Operating Agreement are consistent with Section 6(b)(1) of the Act,<sup>23</sup> which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act, and to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the exchange.

#### a. Transfers

The Commission notes that the amended Operating Agreement contains restrictions on the transfer of interests in BX Equities LLC that are designed to prevent any person from exercising undue control over the operation of the Exchange and to ensure that the Exchange and the Commission are able to carry out their regulatory obligations under the Act. Specifically, the amended Operating Agreement prohibits any person from transferring or assigning its interest in BX Equities LLC, unless such transfer is filed with and approved by the Commission.<sup>24</sup> In addition, the Operating Agreement currently contains a provision that requires any amendment to be submitted to the Exchange's Board of Directors ("Board") for review, and, if

consequences that would be associated with contributing its ownership interest to the Exchange. See Notice, *supra* note 3, 73 FR at 69691.

<sup>21</sup> See Section 4.1, Operating Agreement.

<sup>22</sup> NASDAQ OMX approval would be required for: (i) Converting loans made by a Member to BX Equities LLC into an increase in such Member's Capital Contribution; (ii) an election to dissolve BX Equities LLC; and (iii) any amendment to the Operating Agreement. See Sections 7.4, 11.1 and 18, respectively, Operating Agreement.

<sup>23</sup> 15 U.S.C. 78f(b)(1).

<sup>24</sup> See Section 8.1, Operating Agreement.

such amendment is required to be filed, or filed with and approved by, the Commission before such amendment may be effective, then the amendment will not be effective until filed with, or filed with and approved by, the Commission.<sup>25</sup>

The Operating Agreement no longer will require the Exchange to provide the Commission with written notice ten days prior to the closing date of any acquisition that results in a BX Equities LLC member's percentage ownership interest in BX Equities LLC, alone or with any affiliate, meeting or exceeding the 5%, 10%, or 15% thresholds. Nor will it provide that any transfer of BX Equities LLC interests that result in the acquisition and holding by any person, alone or together with an affiliate, of an interest that meets or crosses the 20% threshold or any successive 5% threshold (*i.e.*, 25%, 30%, *etc.*) triggers the requirement to file an amendment with the Commission under Section 19(b) of the Act.<sup>26</sup> Further, the Operating Agreement no longer will require that any person that acquires a controlling interest (*i.e.*, an interest of 25% or greater) in a BX Equities LLC member that holds 20% or more of BX Equities LLC interests to become a party to the Operating Agreement.

Although proposed changes to provisions in the Operating Agreement on transfer eliminate some of the protections previously contained in the Operating Agreement, the Commission finds that because any transfer of BX Equities LLC interests must be filed with and approved by the Commission,<sup>27</sup> the elimination of the current notice and ownership restrictions in the Operating Agreement would not adversely affect the ability of the Exchange to carry out its self-regulatory responsibilities or the ability of the Commission to fulfill its responsibilities under the Act. The Commission finds that the proposed revisions to the Operating Agreement discussed above are consistent with the Act.

#### b. Confidentiality Provisions

The Operating Agreement provides that all confidential information pertaining to the self-regulatory function of the Exchange or the business of the Exchange related to the trading of U.S. equities (including disciplinary matters, trading data, trading practices and audit information) in the books and records of BX Equities LLC may not be made

<sup>25</sup> See Section 18.1, Operating Agreement.

<sup>26</sup> 15 U.S.C. 78f(b).

<sup>27</sup> See *id.*

available to any persons.<sup>28</sup> The rule proposal will allow such information to be made available to officers, employees and agents of BX Equities LLC who have a reasonable need to know the contents thereof. However, such confidential information shall be required to be retained in confidence by BX Equities LLC and its officers, employees and agents and shall not be used for any non-regulatory purposes.<sup>29</sup> The Commission believes that the revised confidentiality provisions would not impair the Exchange's self-regulatory obligations with respect to BX Equities LLC and finds that this provision is consistent with the Act.

#### 2. Status of the BX Equities Market as a Facility of BX and Delegation of Authority to BX Equities LLC

As a facility of the Exchange, the BX Equities Market will be subject to the Commission's oversight and examination. Consequently, the Commission will have the same authority to oversee the premises, personnel, and records of BX Equities LLC as it currently has with respect to the Exchange. In addition, the Exchange will be fully responsible for all activity that takes place through the BX Equities Market, and BX Equities Market participants will be subject to the Exchange's rules applicable to the BX Equities Market and to Exchange oversight.

As described in detail in the Notice, the Delegation Agreement provides that the Exchange will delegate to BX Equities LLC performance of certain limited responsibilities and obligations of the Exchange with respect to the operation of the BX Equities Market as a cash equities trading facility.<sup>30</sup> The Exchange, however, expressly retains ultimate responsibility for the fulfillment of its statutory and self-regulatory obligations under the Act. Accordingly, as described more fully below, the Exchange will retain ultimate responsibility for such delegated responsibilities and functions, and any actions taken pursuant to delegated authority will remain subject to review, approval or rejections by the Exchange's Board in accordance with procedures established by the Board. The Delegation Agreement will be a part of the Exchange's rules.

<sup>28</sup> See Article 16, Operating Agreement. The Exchange also proposes that the provision would not be interpreted to limit or impede the ability of any officers, directors, employees or agents of BX Equities LLC to disclose confidential information to the Commission or the Exchange.

<sup>29</sup> See *id.*

<sup>30</sup> See Notice, *supra* note 3, 73 FR at 69691.

Pursuant to the Delegation Agreement, the Exchange expressly will retain the authority to: (1) Delegate authority to BX Equities LLC to take actions on behalf of the Exchange; and (2) direct BX Equities LLC to take action necessary to effectuate the purposes and functions of the Exchange, consistent with the independence of the Exchange's regulatory functions, exchange rules, policies and procedures, and the federal securities laws.<sup>31</sup> BX Equities LLC will have delegated authority to, among other things, operate the BX Equities Market, and establish and assess access fees, transaction fees, market data fees and other fees for the products and services offered by BX Equities LLC.<sup>32</sup> In addition, BX Equities LLC will have the authority to act as a SIP for quotations and transaction information related to securities traded on the BX Equities Market and any trading facilities operated by BX Equities LLC.<sup>33</sup>

BX Equities LLC will also have authority to develop, adopt, and administer rules governing participation in the BX Equities Market,<sup>34</sup> but the Exchange represents that it will have ultimate responsibility for the operations, rules and regulations developed by BX Equities LLC, as well as their enforcement.<sup>35</sup> Further, the Exchange represents that actions taken by BX Equities LLC pursuant to its delegated authority will remain subject to review, approval or rejection by the Exchange's Board.<sup>36</sup> In addition, BX Equities LLC will be responsible for referring to the Exchange any complaints of a regulatory nature involving potential rule violations by member organizations or employees,<sup>37</sup> and the Exchange will retain overall responsibility for ensuring that the statutory and self-regulatory functions of the Exchange are fulfilled.<sup>38</sup>

The Commission finds that it is consistent with the Act for the Exchange to delegate the operation of the BX Equities Market to BX Equities LLC, while retaining ultimate responsibility for statutory and self-regulatory obligations and ensuring that BX Equities Market business is conducted in a manner consistent with the requirements of the Act.

<sup>31</sup> See Notice, *supra* note 3, 73 FR at 69694 and Delegation Agreement, Section I.

<sup>32</sup> See Notice, *supra* note 3, 73 FR at 69694 and Delegation Agreement, Section II.A.

<sup>33</sup> See Delegation Agreement, Section II.A.3.

<sup>34</sup> See Delegation Agreement, Section II.A.7.

<sup>35</sup> See Notice, *supra* note 3, 73 FR at 69694.

<sup>36</sup> See *id.*

<sup>37</sup> See Delegation Agreement, Section II.A.8.

<sup>38</sup> See Delegation Agreement, Section I.1.

### B. Proposed Equity Rules

The proposed new Equity Rules are based to a substantial extent on the rules of Nasdaq.<sup>39</sup> In the Notice, the Exchange highlighted the differences between the proposed new Equity Rules and Nasdaq rules.

#### 1. Membership, Registration and Qualifications

The Exchange proposes that the criteria for membership in the Exchange be substantially the same as the criteria currently applicable to firms applying for membership in Nasdaq. As indicated in the Notice, the Equity Rules 1000 series governs membership, registration and qualification and is substantively identical to the corresponding rules for Nasdaq, with a few exceptions to account for the BX Equities Market's structure.<sup>40</sup>

Like Nasdaq rules, the Equity Rules will require a broker-dealer to be a member at all times of at least one other self-regulatory organization ("SRO") before applying for membership in the Exchange.<sup>41</sup> The Equity Rules provide that a registered broker-dealer that was a member organization in good standing of the Exchange on the date immediately prior to the acquisition of the Exchange by NASDAQ OMX is eligible for continued membership if it continues to satisfy the membership requirements of the Equity Rule 1000 Series.<sup>42</sup> Continuing members are required to sign a revised membership agreement and maintain registrations of their associated persons, as required under the Equity Rules.<sup>43</sup> Associated persons already registered with the Exchange likewise will be eligible for continued registration if they satisfy the requirements under the Equity Rules.<sup>44</sup> Unlike members in the Exchange prior to the Exchange's acquisition by NASDAQ OMX, members under the Equity Rules do not possess an ownership interest in the Exchange.

Several registration requirements and categories set forth in Nasdaq rules are not carried over to the BX Equities Market. Equity Rules 1022 and 1032 provide only for principal registration and representative registration categories, as these are the only types of pre-existing BSE membership categories that will be relevant to the future operation and market structure of the

<sup>39</sup> See Notice, *supra* note 3, 73 FR at 69686. The Equity Rules also have the same rule numbers as the corresponding Nasdaq rules.

<sup>40</sup> See Notice, *supra* note 3, 73 FR at 69686.

<sup>41</sup> See Equity Rules 1002 and 1014(a)(3).

<sup>42</sup> See Equity Rule 1002(f).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

Exchange.<sup>45</sup> In addition, because the Equity Rules are modeled on Nasdaq and FINRA rules, approved Nasdaq and FINRA members and their associated persons may apply for membership and registration in a category of registration recognized by the Exchange through an expedited process by submitting a Short Form Membership Application and Agreement.<sup>46</sup>

The Commission finds that the membership rules contained in the Equity Rules are consistent with Section 6 of the Act,<sup>47</sup> specifically Section 6(b)(2) of the Act,<sup>48</sup> which requires that a national securities exchange have rules that provide that any registered broker or dealer or natural person associated with a registered broker or dealer may become a member and any person may become associated with a member thereof. The Commission notes that pursuant to Section 6(c) of the Act,<sup>49</sup> an exchange must deny membership to non-registered broker-dealers and registered broker-dealers that do not satisfy certain standards, such as financial responsibility or operational capacity. In addition, the Commission notes that the membership, registration and qualifications, and access requirements are substantially similar to rules of Nasdaq previously approved by the Commission.<sup>50</sup> The Commission further notes that, as a registered exchange, the Exchange must continue to determine independently if an applicant satisfies the standards set forth in the Act, regardless of whether an applicant is a member of another SRO.

#### 2. Participation and Access

The rules governing access to and participation on the BX Equities Market

<sup>45</sup> See Equity Rules 1022 and 1032.

<sup>46</sup> See Equity Rule 1013(a)(5)(C). The Exchange represents that the requirements for maintaining membership in the Exchange, including compliance with Exchange and Commission rules and submission to examinations, are the same for all members, regardless of the means by which they became members. Moreover, both waive-in members and continuing members are subject to review by FINRA to determine if any information available to FINRA about the member would present concerns regarding the member's standing under FINRA rules. If any such information were presented by FINRA, the Exchange would evaluate it in determining appropriate steps to take with regard to the member. See e-mail from John Yetter, Vice President and Deputy General Counsel, NASDAQ OMX, to Heidi Pilpel, Attorney-Advisor, Division of Trading and Markets, Commission, on December 23, 2008.

<sup>47</sup> 15 U.S.C. 78f(b).

<sup>48</sup> 15 U.S.C. 78f(b)(2).

<sup>49</sup> 15 U.S.C. 78f(c).

<sup>50</sup> See Securities Exchange Act Release No. 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (order approving Nasdaq's application to register as a national securities exchange) ("Nasdaq Registration Approval Order").

also are substantively identical to the corresponding rules of Nasdaq.<sup>51</sup> BX Equities Market participants may include Equities Market Makers, Equities ECNs and Order Entry Firms.<sup>52</sup> The Exchange also will provide authorized access for Sponsored Participants.<sup>53</sup> However, only Equities Market Makers, or participants acting in a market making capacity, will be permitted to submit quotes.<sup>54</sup> In addition, like Nasdaq market makers, Equities Market Makers will be obligated to submit firm, continuous, two-sided quotations, with a minimum quotation increment of \$0.01.<sup>55</sup>

The Commission notes that the access and participation requirements in the Equity Rules are substantially similar to Nasdaq's access and participation requirements, and, accordingly, finds that they are consistent with the Act. In particular, the BX Equities Market system ("System") is designed to match buying and selling interest of all Exchange participants. In addition, the Commission believes that the access and participation rules should help to ensure that Equities Market Makers perform their obligations in a manner that promotes just and equitable principles of trade.

### 3. BX Trading System and Regulation NMS Compliance

#### a. BX Trading System

The Exchange's System for trading cash equity securities will operate using technology and rules similar to Nasdaq. Accordingly, the BX Equities Market will feature an electronic central limit order book, with executions occurring in price/time priority (but with displayed orders receiving priority over non-displayed orders).<sup>56</sup> While the BX Equities Market and Nasdaq will operate similarly in most aspects, there will be certain differences between the two markets. In particular:

- The BX Equities Market will operate from 8 a.m. to 7 p.m. Eastern Time (rather than from 7 a.m. to 8 p.m.). Like Nasdaq, regular market hours will be from 9:30 a.m. to 4 p.m. (or 4:15 p.m. for any exchange-traded funds that may be so designated by the Exchange).<sup>57</sup>

- The BX Equities Market will not operate an opening cross, a closing cross, or a halt cross. It will begin to process all eligible quotes/orders at 8 a.m., adding in time priority all eligible orders in accordance with each order's defined characteristics. All trades executed prior to 9:30 a.m. will be automatically appended with the "T" modifier. The official opening price for a security listed on the Exchange will be the price of the first trade executed at or after 9:30 a.m. and the official closing price will be the price of the last trade executed at or prior to 4 p.m.<sup>58</sup>

- Quoting market participants may instruct the Exchange to open their quotes at 9:25 a.m. at a price of \$0.01 (bid) and \$999,999 (offer) and a size of one round lot in order to provide a two-sided quotation. In all other cases, the quote of a participant will be at the price and size entered by the participant.<sup>59</sup>

- If trading of a security is halted under Equity Rule 4120, the security will be released for trading at a time announced to market participants by the Exchange.<sup>60</sup>

- The Exchange's quotation and trade reporting information is disseminated under the Consolidated Quotation Plan ("CQ Plan") and Consolidated Tape Association Plan ("CTA Plan"), rather than the Nasdaq UTP Plan.<sup>61</sup>

- Nasdaq rules relating to passive market making under Rule 103 of Regulation M under the Act<sup>62</sup> are not included because that rule does not apply to any other exchange, even if it adopts a similar market structure.<sup>63</sup>

- Equity Rule 4620 provides that an Exchange market maker that terminates its registration in a security listed on the Exchange may not re-register as a market maker in that security for a period of twenty business days, with a one-day exclusion period for all other securities.<sup>64</sup>

- The Exchange will not support discretionary orders, orders with a "market hours" time-in-force designation (with the exception of "market hours day" orders), or orders with a "system hours good till cancelled" time-in-force designation.<sup>65</sup>

- The Exchange will not support an automatic quotation refresh functionality.<sup>66</sup> Thus, market makers will be required to maintain continuous

two-sided quotations without the assistance of the functionality. In addition, the Exchange will not allow market participants to maintain quotes or orders on the book overnight; rather, all quotes and orders will be cancelled at the end of the trading day and must be re-entered, if market participants so desire, the following day.<sup>67</sup>

The Commission finds that the Exchange's execution priority rules and trading rules are consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be 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, and 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.<sup>68</sup> Section 6(b)(5) also requires that the rules of an exchange not be designed to permit unfair discrimination among customers, issuers, brokers, or dealers. The Exchange market model for the trading of cash equity securities is similar to Nasdaq's equity market model and does not raise novel issues.

#### b. Regulation NMS

The Exchange has designed its rules relating to orders, modifiers, and order execution to comply with requirements of Regulation NMS. Unlike Nasdaq, the Exchange will not route orders in equity securities to other market centers. The Equity Rules are consistent with Regulation NMS<sup>69</sup> by requiring that all orders be processed in a manner that avoids trading through protected quotations and avoids locked and crossed markets.<sup>70</sup> Specifically, Equity Rule 4755 provides that in addition to such other designations as may be chosen by a market participant,<sup>71</sup> all orders that are not entered with a time in force of "System Hours Immediate or Cancel"<sup>72</sup> must be designated as an

<sup>51</sup> See, e.g., Equity Rules 4610 *et seq.*

<sup>52</sup> See Equity Rule 4611.

<sup>53</sup> See Securities Exchange Act Release Nos. 55061 (January 8, 2007), 72 FR 2052 (January 17, 2007) (notice of filing and immediate effectiveness of File No. SR-Nasdaq-2006-061) (adopting Nasdaq Rule 4611(d)); and 55550 (March 28, 2007), 72 FR 12 16389 (April 4, 2007) (notice of filing and immediate effectiveness of File No. SR-Nasdaq-2007-010) (revising Nasdaq Rule 4211(d)).

<sup>54</sup> See Equity Rule 4612.

<sup>55</sup> See Equity Rule 4613.

<sup>56</sup> See Notice, *supra* note 3, 73 FR at 69688.

<sup>57</sup> See Equity Rule 4617.

<sup>58</sup> See Notice, *supra* note 3, 73 FR at 69688.

<sup>59</sup> See Equity Rule 5752.

<sup>60</sup> See Equity Rule 4120.

<sup>61</sup> See Notice, *supra* note 3, 73 FR at 69688.

<sup>62</sup> 17 CFR 242.103.

<sup>63</sup> See *id.*

<sup>64</sup> See Equity Rule 4620.

<sup>65</sup> See Notice, *supra* note 3, 73 FR at 69688.

<sup>66</sup> See *id.*

<sup>67</sup> See *id.*

<sup>68</sup> 15 U.S.C. 78f(b)(5).

<sup>69</sup> 17 CFR 242.611.

<sup>70</sup> See Equity Rule 4755(b).

<sup>71</sup> As is the case with Nasdaq, different order designations can be combined. Thus, for example, a Price to Comply Order could be entered with reserve size or as a non-displayed order.

<sup>72</sup> A "System Hours Immediate or Cancel" order is an immediate or cancel order that may be entered between 8 a.m. and 7 p.m. Eastern Time, the hours of operation of the BX Equities Market. If a System Hours Immediate or Cancel order (or a portion thereof) is not marketable, the order (or unexecuted

Intermarket Sweep Order, a Pegged Order, a Price to Comply Order, or a Price to Comply Post Order.<sup>73</sup>

As described in the Notice, a System Hours Immediate or Cancel Order is compliant with Regulation NMS because by its terms it would not execute or post at a price that would result in a trade-through of a protected quotation or lock or cross another market.<sup>74</sup> A Pegged Order similarly is compliant with Regulation NMS because it continually re-prices to avoid locking or crossing.<sup>75</sup>

The Equity Rules also permit BX Equities Market participants to submit Intermarket Sweep Orders to comply with Regulation NMS, which will allow orders so designated to be automatically matched and executed within the System.<sup>76</sup> As described in the Notice, when a market participant enters an Intermarket Sweep Order it is representing that it is also simultaneously routing one or more additional limit orders (also marked as Intermarket Sweep Orders), as necessary, to execute against the full displayed size of any protected bid or offer (as defined in Rule 600(b) of Regulation NMS) in the case of a limit order to sell or buy with a price that is superior to the limit price of the order identified as an Intermarket Sweep Order.<sup>77</sup>

Both a Price to Comply and a Price Comply Post Order are designed to comply with the Regulation NMS.<sup>78</sup> Specifically, if at the time of entry, a Price to Comply Order will lock or cross the quotation of an external market, the order will be priced to the current low offer (for bids) or to the current best bid (for offers) but displayed at a price one minimum price increment lower than the offer (for bids) or higher than the bid (for offers).<sup>79</sup> Thus, an incoming order priced to execute against the displayed price will receive the superior undisplayed price.<sup>80</sup> If, at the time of

portion thereof) is canceled and returned to the entering participant. See Equity Rule 4751(h)(1).

<sup>73</sup> See Equity Rule 4755(a)(2).

<sup>74</sup> See Notice, *supra* note 3, 73 FR at 69688; Equity Rule 4751(h)(1).

<sup>75</sup> See Equity Rule 4751(f).

<sup>76</sup> See Equity Rules 4751(f)(6) and 4757.

<sup>77</sup> The Exchange represented that members will be responsible for ensuring that their use of Intermarket Sweep Orders complies with Regulation NMS, and the Exchange's T+1 surveillance program will monitor members' use of Intermarket Sweep Orders. See Notice, *supra* note 3, 73 FR at 69688.

<sup>78</sup> See Notice, *supra* note 3, 73 FR at 69688–69689.

<sup>79</sup> See Rule 4751(f)(7).

<sup>80</sup> For example, if the national best bid and best offer is \$9.97 × \$10.00, and a participant enters a Price to Comply Order to buy 10,000 shares at \$10.01, the order will display at \$9.99, but will

entry, a Price to Comply Post Order will lock or cross the protected quote of an external market or will cause a violation of Rule 611 of Regulation NMS, the order will be re-priced and displayed to one minimum price increment (*i.e.*, \$0.01 or \$0.0001) below the current low offer (for bids) or to one penny above the current best bid (for offers).<sup>81</sup>

The Commission believes that by requiring all orders to be entered with one of the designations described above, all Exchange orders should either be priced or cancelled in a manner consistent with the avoidance of trade-throughs and locked and crossed markets. The Commission also notes that, because the Exchange will not route orders to other market centers, the Exchange's Regulation NMS policies and procedures under Rule 611(a) will rely on information provided by Nasdaq for purposes of determining whether another trading center is experiencing a failure, material delay, or malfunction of its systems or equipment within the meaning of Rule 611(b)(1).

The Commission finds that the rules relating to orders, modifiers, and order execution that are designed to comply with Regulation NMS are consistent with Section 6(b)(5) of the Act, which requires among other things, that the rules of a national securities exchange be 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, and 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.

#### 4. Section 11 of the Act

Section 11(a)(1) of the Act<sup>82</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

reside on the System book at \$10.00. If a seller then enters an order at \$9.99, it will execute at \$10.00, up to the full 10,000 shares of the order. The displayed and undisplayed prices of a Price to Comply Order may be adjusted once or multiple times depending upon the method of order entry and changes to the prevailing national best bid/best offer.

<sup>81</sup> See Equity Rule 4751(f)(8). For example, if the national best bid and best offer is \$9.97 × \$10.00, and a participant enters a Price to Comply Post Order to buy at \$10.01, the order will be repriced and displayed at \$9.99. If a seller enters an order at \$9.99, it will execute at that price.

<sup>82</sup> 15 U.S.C. 78k(a)(1).

person exercises discretion (collectively, “covered accounts”), unless an exception applies. Rule 11a2–2(T) under the Act,<sup>83</sup> known as the “effect versus execute” rule, provides exchange members with an exemption from the Section 11(a)(1) 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;<sup>84</sup> (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 connection with effecting the transaction except as provided in the Rule.

In a letter to the Commission,<sup>85</sup> the Exchange requested that the Commission concur with its conclusion that Exchange members that enter orders into the System satisfy the requirements of Rule 11a2–2(T). For the reasons set forth below, the Commission believes that Exchange members entering orders into the System would satisfy the conditions of the Rule.

The Rule's first condition is that orders for covered accounts be transmitted from off the exchange floor. The System receives orders electronically through remote terminals or computer-to-computer interfaces. In the context of other automated trading systems, the Commission has found 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>86</sup> Since the System

<sup>83</sup> 17 CFR 240.11a2–2(T).

<sup>84</sup> The member may, however, participate in clearing and settling the transaction.

<sup>85</sup> See letter from John Zecca, Chief Regulatory Officer, Exchange, to Florence Harmon, Acting Secretary, Commission, dated December 23, 2008 (“BSE 11(a) Request Letter”).

<sup>86</sup> See, *e.g.*, Nasdaq Registration Approval Order, *supra* note 50 Securities Exchange Act Release Nos. 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004) (order approving the Boston Options Exchange as an options trading facility of the Boston Stock Exchange); 44983 (October 25, 2001), 66 FR 55225 (November 1, 2001) (order approving Archipelago Exchange as electronic trading facility of the Pacific Exchange (“PCX”)); 29237 (May 24, 1991), 56 FR 24853 (May 31, 1991) (regarding NYSE's Off-Hours Trading Facility); 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) (regarding the American Stock Exchange (“Amex”) Post

receives orders electronically through remote terminals or computer-to-computer interfaces, the Commission believes that the System satisfies the off-floor transmission requirement.

Second, the rule requires that the member not participate in the execution of its order. The Exchange represented that at no time following the submission of an order is a member able to acquire control or influence over the result or timing of an order's execution.<sup>87</sup> According to the Exchange, the execution of a member's order is determined solely by what orders, bids, or offers are present in the System at the time the member submits the order and on the priority of those orders, bids and offers. Accordingly, the Commission believes that an Exchange member does not participate in the execution of an order submitted into the System.

Third, Rule 11a2-2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that the requirement is satisfied when automated exchange facilities, such as the System, are used, as long as 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 Exchange.<sup>88</sup> The Exchange has

Execution Reporting System, the Amex Switching System, the Intermarket Trading System, the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange, the PCX Communications and Execution System, and the Philadelphia Stock Exchange ("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 ("1978 Release")).

<sup>87</sup> See BSE 11(a) Request Letter, *supra* note 85. The member may only cancel or modify the order, or modify the instructions for executing the order, but only from off the Exchange floor. The Commission has stated that the non-participation requirement is satisfied under such circumstances so long as such modifications or cancellations are also transmitted from off the floor. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (stating that the "non-participation requirement does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor").

<sup>88</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 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 86.

represented that the design of the System ensures that no member has any special or unique trading advantage in the handling of its orders after transmitting its orders to the Exchange.<sup>89</sup> Based on the Exchange's representation, the Commission believes that the System satisfies this requirement.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T).<sup>90</sup> The Exchange represented that Exchange members trading for covered accounts over which they exercise investment discretion must comply with this condition in order to rely on the rule's exemption.<sup>91</sup>

#### C. Exception to Limitation on Affiliation Between BX and its Members

Although the Exchange will not route orders to other market centers, it proposes to receive orders routed to it by other market centers, including orders routed from Nasdaq.<sup>92</sup> BSE Rule Chapter XXXIX, Section 2 prohibits BSE members from being affiliated with BSE.<sup>93</sup> Proposed Equity Rule 2140(a) is identical to BSE Rule Chapter XXXIX, Section 2, and prohibits the Exchange or any entity with which it is affiliated,

<sup>89</sup> See BSE 11(a) Request Letter, *supra* note 85.

<sup>90</sup> 17 CFR 240.11a2-2(T)(a)(2)(iv). In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated person thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member in connection with effecting transactions for the account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d). See also 1978 Release, *supra* note 86 (stating "[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

<sup>91</sup> See BSE 11(a) Request Letter, *supra* note 85.

<sup>92</sup> See Notice, *supra* note 3, 73 FR at 69689.

<sup>93</sup> See BSE Approval Order, *supra* note 7, 73 FR at 46943-49644. The Exchange proposed, and the Commission approved, that the affiliation also be subject to the following conditions and limitations: (1) NES is operated as a facility of Nasdaq; (2) for purposes of Commission Rule 17d-1 under the Act, 17 CFR 240.17d-1, the designated examining authority of NES is a self-regulatory organization unaffiliated with Nasdaq; and (3) use of NES to route orders to other market centers is optional. *Id.*

from acquiring or maintaining an ownership interest in a member without prior Commission approval.

NES is a broker-dealer that is a member of the Exchange, and currently provides to Nasdaq members optional routing services to other market centers. NES is owned by NASDAQ OMX, which also owns three registered securities exchanges—Nasdaq, the Exchange, and Phlx.<sup>94</sup> Thus, NES is an affiliate of each of these exchanges. Absent Commission approval, Equity Rule 2140(a) would prohibit NES from being a member of the Exchange.

In connection with NASDAQ OMX's acquisition of the Exchange, the Commission approved the current affiliation between the Exchange and NES for the limited purpose of permitting NES to provide routing services for Nasdaq for orders that first attempt to access liquidity on Nasdaq's system before routing to the Exchange, subject to certain other limitations and conditions.<sup>95</sup> At the time of NASDAQ OMX's acquisition of the Exchange, the Exchange was not trading equity securities.<sup>96</sup> Now, in connection with the Exchange's resumption of equity trading pursuant to the instant proposed rule change, the Exchange proposes to modify the conditions for the affiliation between NES and the Exchange, previously approved by the Commission, to permit the Exchange to receive orders routed by NES in its capacity as a facility of Nasdaq (including "Directed Orders"),<sup>97</sup> on a one-year pilot basis.<sup>98</sup>

NES operates as a facility of Nasdaq that provides outbound routing from Nasdaq to other market centers, subject to certain conditions.<sup>99</sup> NES's operation as a facility providing outbound routing services for Nasdaq is subject to the conditions that: (1) NES is operated and regulated as a facility of Nasdaq; (2) NES only provides outbound routing services unless otherwise approved by the

<sup>94</sup> See BSE Approval Order, *supra* note 7, 73 FR at 46943. See also Securities Exchange Act Release No. 58179 (July 17, 2008), 73 FR 42874 (July 23, 2008) (order approving NASDAQ OMX's acquisition of Phlx.)

<sup>95</sup> BSE Rule Chapter XXXIX, Section 2 was adopted in the BSE Approval Order (see *supra* note 7, 73 FR at 46944), and is proposed to be replaced by Equity Rule 2140(a).

<sup>96</sup> See BSE Approval Order, *supra* note 7, 73 FR at 49644, n.117.

<sup>97</sup> Nasdaq Rule 4751(f)(9) defines Directed Orders as immediate-or-cancel orders that are directed to an exchange other than Nasdaq without checking the Nasdaq book. Pursuant to Nasdaq Rule 4751(f)(9), Nasdaq currently may not route Directed Orders to a facility of an exchange that is an affiliate of Nasdaq.

<sup>98</sup> See Notice, *supra* note 3, 73 FR at 69689.

<sup>99</sup> See Nasdaq Rules 4751 and 4758. See also Notice, *supra* note 3, 73 FR at 69689.



Commission; (3) the designated examining authority of NES is a self-regulatory organization unaffiliated with Nasdaq; and (4) the use of NES for outbound routing is available only to Nasdaq members and the use of NES remains optional. Currently, NES may not route Directed Orders to a facility of an exchange that is an affiliate of Nasdaq.<sup>100</sup> Nasdaq has proposed, and the Commission approved today, a rule change to permit NES to route all forms of orders, including Directed Orders, to the BX Equities Market.<sup>101</sup>

The operation of NES as a facility of Nasdaq providing outbound routing services from that exchange will be subject to Nasdaq oversight, as well as Commission oversight. Nasdaq will be responsible for ensuring that NES's outbound routing function is operated consistent with Section 6 of the Act and Nasdaq rules. In addition, Nasdaq must file with the Commission rule changes and fees relating to NES's outbound routing function.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange of which it is a member, the Exchange previously proposed, and the Commission approved, limitations and conditions on NES's affiliation with the Exchange.<sup>102</sup> Also recognizing that the Commission has expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange to which it is routing orders, the Exchange now proposes to revise the conditions to NES's affiliation with the Exchange to permit the Exchange to accept inbound orders that NES routes in its capacity as a facility of Nasdaq, subject to the following limitations and conditions:

- First, the Exchange states that the Exchange and FINRA will enter into a Regulatory Contract, as well as an agreement pursuant to Rule 17d-2 under the Act ("17d-2 Agreement").<sup>103</sup> Pursuant to the Regulatory Contract and the 17d-2 Agreement, FINRA will be allocated regulatory responsibilities to review NES's compliance with certain Exchange rules.<sup>104</sup> Pursuant to the Regulatory Contract, however, BX

retains ultimate responsibility for enforcing its rules with respect to NES.

- Second, FINRA will monitor NES for compliance with the Exchange's trading rules, and will collect and maintain certain related information.<sup>105</sup>

- Third, the Exchange states that FINRA has agreed with the Exchange that it will provide a report to the Exchange's chief regulatory officer ("CRO"), on a quarterly basis, that: (i) Quantifies all alerts (of which FINRA is aware) that identify NES as a participant that has potentially violated Commission or Exchange rules, and (ii) lists all investigations that identify NES as a participant that has potentially violated Commission or Exchange rules.<sup>106</sup>

- Fourth, the Exchange proposes Rule 2140(c), which will require NASDAQ OMX, as the holding company owning both the Exchange and NES, to establish and maintain procedures and internal controls reasonably designed to ensure that NES does not develop or implement changes to its system, based on non-public information obtained regarding planned changes to the Exchange's systems as a result of its affiliation with the Exchange, until such information is available generally to similarly situated Exchange members, in connection with the provision of inbound order routing to the Exchange.<sup>107</sup>

- Fifth, the Exchange proposes that routing of orders from NES to the Exchange, in NES's capacity as a facility of Nasdaq, be authorized for a pilot period of twelve months.<sup>108</sup>

In the past, the Commission has expressed concern that the affiliation of an exchange with one of its members raises potential conflicts of interest, and the potential for unfair competitive advantage.<sup>109</sup> Although the Commission

continues to be concerned about potential unfair competition and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, for the reasons discussed below, the Commission believes that it is consistent with the Act to permit NES to provide inbound routing to the Exchange on a pilot basis, subject to the conditions described above.

The Exchange has proposed five conditions applicable to NES's routing activities, which are enumerated above. The Commission believes that these conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that FINRA's oversight of NES,<sup>110</sup> combined with FINRA's monitoring of NES's compliance with the equity trading rules and quarterly reporting to the Exchange's CRO, will help to protect the independence of the Exchange's regulatory responsibilities with respect to NES. The Commission also believes that the proposed addition of Equity Rule 2140(c) is designed to ensure that NES cannot use any information advantage it may have because of its affiliation with the Exchange. Furthermore, the Commission believes that the Exchange's proposal to allow NES to route orders inbound to the Exchange from Nasdaq, on a pilot basis, will provide the Exchange and the Commission an opportunity to assess the impact of any conflicts of interest of allowing an affiliated member of the Exchange to route orders inbound to the Exchange and whether such affiliation provides an unfair competitive advantage.

#### D. Securities Traded on the Exchange

The Equity Rule 4000 series includes the rules governing listing and trading of cash equity securities on the Exchange. The Exchange proposes to adopt initial and continued listing standards for primary and secondary classes of common stock, preferred stock, convertible debt, rights and warrants, shares or certificates of beneficial interest of trusts, foreign securities, American Depositary

restricting affiliations between Nasdaq and its members); 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving the combination of the New York Stock Exchange, Inc. and Archipelago Holdings, Inc.); and 58673 (September 29, 2008), 73 FR 57707 (October 8, 2008) (SR-Amex-2008-62) (order approving the combination of NYSE Euronext and the American Stock Exchange LLC).

<sup>110</sup> This oversight will be accomplished through the 17d-2 Agreement between FINRA and the Exchange and the Regulatory Contract.

<sup>105</sup> Pursuant to the Regulatory Contract, both FINRA and the Exchange will collect and maintain all alerts, complaints, investigations and enforcement actions in which NES (in its capacity as a facility of Nasdaq routing orders to the Exchange) is identified as a participant that has potentially violated applicable Commission or Exchange rules. The Exchange and FINRA will retain these records in an easily accessible manner in order to facilitate any potential review conducted by the Commission's Office of Compliance Inspections and Examinations. See Notice, *supra* note 3, 73 FR at 69689.

<sup>106</sup> See *id.*

<sup>107</sup> See Equity Rule 2140(c). See also Notice, *supra* note 3, 73 FR at 69689-69690.

<sup>108</sup> See Amendment No. 2, *supra* note 5. In Amendment No. 2, the Exchange clarified that its proposal, as opposed to Nasdaq's corresponding proposal, be approved on a twelve-month pilot basis. See also Notice, *supra* note 3, 73 FR at 69689, n.15 and accompanying text.

<sup>109</sup> See, e.g., Securities Exchange Act Release Nos. 54170 (July 18, 2006), 71 FR 42149 (July 25, 2006) (SR-NASDAQ-2006-006) (order approving Nasdaq's proposal to adopt Nasdaq Rule 2140,

<sup>100</sup> *Id.* See also *supra* note 7.

<sup>101</sup> See Securities Exchange Act Release No. 59154 (December 23, 2008) (SR-Nasdaq-2008-091).

<sup>102</sup> See BSE Approval Order, *supra* note 7, 73 FR at 49644.

<sup>103</sup> 17 CFR 240.17d-2.

<sup>104</sup> The Exchange also states that NES is subject to independent oversight by FINRA, its Designated Examining Authority, for compliance with financial responsibility requirements. See Notice, *supra* note 3, 73 FR at 69689.



Receipts (“ADRs”), and limited partnership interests that are identical to Nasdaq’s listing standards for the Nasdaq Capital Market, Nasdaq’s most permissive listing standards.<sup>111</sup> The standards for initial and continued listing of these securities are set forth in the proposed Equity Rule 4300 Series.<sup>112</sup>

In addition, the Exchange proposes to adopt, in Equity Rules 4420 and 4450, initial and continued listing standards for Selected Equity-linked Debt Securities (“SEEDS”), units, index warrants, portfolio depository receipts, index fund shares, trust issued receipts, linked securities, managed fund shares, and “other securities” that would be substantively identical to those of the Nasdaq Global Market.<sup>113</sup> The listing standards for SEEDS and “other securities” would differ slightly from the comparable Nasdaq standards, in that they require issuers of securities listed thereunder to be eligible for listing on the Nasdaq or the New York Stock Exchange (“NYSE”) or to be affiliates of companies that are so eligible, rather than being required to be actually so listed. This difference recognizes the fact that an issuer seeking to list a SEED or “other security” on the Exchange would not necessarily also have a security listed on Nasdaq or the NYSE, but it would nevertheless be required to demonstrate ability to meet such other listing standards before listing the SEED or “other security.” The proposed equity rules do not include the provisions of Nasdaq Rules 4426 and 4427, which establish standards for Nasdaq’s Global Select Market tier.<sup>114</sup> The Commission finds the Exchange’s proposed initial and

continued listing standards are consistent with the Act, including Section 6(b)(5), in that they are designed to protect investors and the public interest and to promote just and equitable principles of trade.<sup>115</sup>

#### *E. Regulation of the Exchange and Its Members*

As a facility of the Exchange, the BX Equities Market will be subject to the Exchange’s SRO functions and the Exchange will have regulatory responsibility for the activities of the BX Equities Market. The Exchange represents that it has the ability to discharge all regulatory functions related to the facility that it has undertaken to perform by virtue of operating the BX Equities Market as a facility of the Exchange.<sup>116</sup> In addition, the amended Operating Agreement contains provisions relating to the governance of the BX Equities LLC that will ensure that the Exchange has authority over BX Equities LLC to fulfill the Exchange’s responsibility for all regulatory functions related to the BX Equities Market. The Exchange represented that its proposed corporate and self-regulatory structure, along with the proposed structure of BX Equities LLC as a controlled subsidiary of the Exchange, are sufficient to ensure that BX Equities LLC and the BX Equities Market will be operated and regulated in a manner that is consistent with the Act.<sup>117</sup>

In connection with the proposed rule change, the Exchange noted that its Regulatory Oversight Committee and its CRO will assume responsibility for regulating quoting and trading on the BX Equities Market and conduct by its

members.<sup>118</sup> The Exchange’s CRO has general supervision of the regulatory operations of the Exchange, including overseeing surveillance, examination, and enforcement functions, and will administer the Regulatory Contract between the Exchange and FINRA.<sup>119</sup>

The Regulatory Contract between the Exchange and FINRA governs the Exchange and its facilities and therefore will automatically govern the BX Equities Market and Exchange members trading on it.<sup>120</sup> Notwithstanding the Regulatory Contract, the Exchange retains ultimate legal responsibility for the regulation of its members and its market. The Exchange’s By-Laws and rules provide that it has disciplinary jurisdiction over its members so that it can enforce its members’ compliance with its rules and the federal securities laws.<sup>121</sup> The Exchange’s rules also permit it to sanction members for violations of its rules and violations of the federal securities laws by, among other things, expelling or suspending members, limiting members’ activities, functions, or operations, fining or censuring members, or suspending or barring a person from being associated with a member.<sup>122</sup> The Exchange’s rules also provide for the imposition of fines for minor rule violations in lieu of commencing disciplinary proceedings.<sup>123</sup>

The Exchange’s Regulation Department will carry out many of the Exchange’s regulatory functions, including administering its membership and disciplinary rules, and is functionally separate from the Exchange’s business lines. The Exchange represents that the Regulation Department includes MarketWatch, which will perform real-time intraday surveillance over the Exchange’s listed companies and participants in the BX Equities Market. More specifically, MarketWatch will oversee the complete and timely disclosure of issuers’ material information to determine if a trading halt is necessary to maintain an

<sup>111</sup> Nasdaq has three progressively higher listing tiers—the Nasdaq Capital Market, the Nasdaq Global Market, and the Nasdaq Global Select Market. Securities listed on the Nasdaq Capital Market are “covered securities” for purposes of Section 18 of the Securities Act of 1933, 15 U.S.C. 77r (“Securities Act”), and are therefore exempt from state law registration requirements. See Securities Act Release No. 8791 (April 18, 2007), 72 FR 20410 (April 24, 2008) (File No. S7–18–06). In the Notice, the Exchange stated that it anticipates petitioning the Commission to amend Rule 146 under the Securities Act to recognize securities listed on the Exchange as covered securities. See Notice, *supra* note 3, 73 FR at 69688.

<sup>112</sup> See Equity Rules 4310 and 4320.

<sup>113</sup> See Equity Rules 4420 and 4450. The Exchange’s proposed listing standards for units combine elements of the standards of the Nasdaq Capital Market and the Nasdaq Global Market, in that they require the equity component of a unit to satisfy standards equivalent to Nasdaq Capital Market standards but allow the inclusion of a debt component that is not itself eligible for listing but that meets the requirements of Equity Rule 4420(h)(1)(B).

<sup>114</sup> The Equity Rule 4600 series is being reserved for the Exchange’s listing fees, which will be included in a separate filing.

<sup>115</sup> 15 U.S.C. 78f(b)(5). The Commission notes that the Exchange’s initial and continued listing standards for primary and secondary classes of common stock, preferred stock, convertible debt, rights and warrants, shares or certificates of beneficial interest of trusts, foreign securities, ADRs and limited partnership interests are identical to the existing standards for the Nasdaq Capital Market, which the Commission previously approved. Likewise, the Exchange’s initial and continued listing standards for units, index warrants, portfolio depository receipts, index fund shares, trust issued receipts, linked securities, managed fund shares and other securities are identical to those approved for the Nasdaq Global Market, which the Commission also previously approved. See Nasdaq Registration Approval Order, *supra* note 50.

<sup>116</sup> See Notice, *supra* note 3, 73 FR at 69691, and BSE Approval Order, *supra* note 7, 73 FR at 46944 for a description of the protections, limitations, and requirements the Commission previously approved in connection with the governing structure of NASDAQ OMX and of the Exchange, which are designed to protect the self-regulatory function of the Exchange and preserve its independence.

<sup>117</sup> See Notice, *supra* note 3, 73 FR at 69691.

<sup>118</sup> Each broker-dealer that participates in trading on the BX Equities Market must be a member of the Exchange. See Notice, *supra* note 3, 73 FR at 69693.

<sup>119</sup> Pursuant to the Regulatory Contract, FINRA will perform certain regulatory functions on behalf of the Exchange. In addition to performing certain membership functions for the Exchange, FINRA will perform certain disciplinary and enforcement functions for the Exchange. Generally, FINRA will investigate members, issue complaints, and conduct hearings pursuant to the Exchange’s rules. Appeals of disciplinary hearings, however, will be handled by the Nasdaq Review Council. See Notice, *supra* note 3, 73 FR at 69690.

<sup>120</sup> See *id.* at 69692.

<sup>121</sup> See, e.g., Exchange By-Laws, Article IX, Section 2.

<sup>122</sup> See, e.g., Equity Rule 8310.

<sup>123</sup> See, e.g., Equity Rule 9216(b).

orderly market for the release of material news. In addition, MarketWatch, through its automated detection system, will monitor the trading activity of each security and will generate a price and volume alert to aid in the assessment of unusual market activity. MarketWatch will also coordinate and execute the release of initial public offerings; administer market participants' excused withdrawal requests; and handle the clearly erroneous trade adjudication process. If MarketWatch observes any activity that may involve a violation of Commission or Exchange rules, MarketWatch will immediately refer the activity to FINRA's Market Regulation Department for further investigation and potential disciplinary action. The Equity Rules governing unusual market conditions, extraordinary market volatility, and audit trail are modeled on the rules of Nasdaq.<sup>124</sup> With regard to trading halts, if trading of a security is halted under Equity Rule 4120, the security will be released for trading at a time announced to market participants by the Exchange. Because the Exchange will not have a halt cross, provisions of Nasdaq 4120 relating to a "display only" period prior to the execution of the halt cross are not included.

The Commission finds that the Exchange's proposed rules relating to the regulation of the BX Equities Market and its members are consistent with the requirements of the Act, and in particular with Section 6(b)(1) of the Act, which requires an exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the Act and the rules and regulations thereunder, and the rules of the Exchange,<sup>125</sup> and with Sections 6(b)(6) and 6(b)(7) of the Act,<sup>126</sup> which require an Exchange to provide fair procedures for the disciplining of members and persons associated with members.

### 1. Regulatory Contract

The Exchange represents that the Regulatory Contract between the Exchange and FINRA governs the Exchange and its facilities.<sup>127</sup> Therefore, because the BX Equities Market will be a facility of the Exchange, the Regulatory Contract will govern the BX Equities Market.<sup>128</sup> The Exchange and

FINRA also are parties to an agreement pursuant to Section 17(d) of the Act and Rule 17d-2 thereunder. A regulatory matter involving an Exchange member that is also a FINRA member, and that is governed by both the Regulatory Contract and the 17d-2 Agreement will be administered by FINRA pursuant to the 17d-2 Agreement.

The Commission notes that the Exchange will continue to bear ultimate regulatory responsibility for functions performed on its behalf under the Regulatory Contract. Further, the Exchange retains ultimate legal responsibility for the regulation of its members and its market (including its facility, the BX Equities Market).

The Commission believes that it is consistent with the Act and the public interest to allow the Exchange to contract with FINRA to perform membership, disciplinary, and enforcement functions.<sup>129</sup> Membership, discipline, and enforcement are fundamental elements to a regulatory program, and constitute core self-regulatory functions. It is essential to the public interest and the protection of investors that these functions are carried out in an exemplary manner. With respect to certain regulatory functions contracted to FINRA by the Exchange, including membership, disciplinary and enforcement functions, the Commission previously noted its belief that FINRA has the expertise and experience to perform such functions on behalf of an exchange, and that the contracting of such functions to FINRA is consistent with the Act and the public interest.<sup>130</sup> The Commission continues to believe that this is true with respect to the inclusion in the Regulatory Contract of regulation of the Exchange and the conduct of its members.

"[The] Rules that refer to the Exchange's Regulation Department, Regulation Department staff, Exchange staff, and Exchange departments should be understood as also referring to FINRA staff and FINRA departments acting on behalf of the Exchange pursuant to the FINRA Regulatory Contract. See Equity Rule 0130.

<sup>129</sup> See, e.g., Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998). See also Securities Exchange Act Release Nos. 57478 (March 12, 2008) 73 FR 14521, (March 18, 2008) (order approving rules governing the trading of options on the NASDAQ Options Market) ("NOM Approval Order"); 50122 (July 29, 2004), 69 FR 47962 (August 6, 2004) (order approving File No. SR-Amex-2004-32) ("Amex Approval Order"); 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (File No. 10-127) (approving ISE's registration as a national securities exchange) ("ISE Exchange Registration Order") at III(D)(2); Nasdaq Registration Approval Order, *supra* note 50.

<sup>130</sup> See Nasdaq Registration Approval Order, *supra* note 50, at notes 10 and 11 and accompanying text.

The Exchange, unless relieved by the Commission of its responsibility,<sup>131</sup> shall bear the responsibility for self-regulatory conduct and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on the Exchange's behalf.<sup>132</sup> In performing these functions, however, FINRA may nonetheless bear liability for causing or aiding and abetting the failure of the Exchange to perform its regulatory functions.<sup>133</sup> Accordingly, although FINRA will not act on its own behalf under its SRO responsibilities in carrying out these regulatory services for the Exchange relating to the operation of the BX Equities Market, FINRA also may have secondary liability if, for example, the Commission finds that the contracted functions are being performed so inadequately as to cause a violation of the federal securities laws by the Exchange.<sup>134</sup>

### 2. 17d-2 Agreement

Rule 17d-2 allows SROs to file with the Commission plans under which the SROs allocate among themselves the responsibility to receive regulatory reports from, and examine and enforce compliance with, specified provisions of the Act and rules thereunder and SRO rules by firms that are members of more than one SRO ("common members"). An SRO that is a party to an effective 17d-2 plan is relieved of regulatory responsibility as to any common member for whom responsibility is allocated under the plan to another SRO.<sup>135</sup> The Commission notes that the Exchange has entered into a 17d-2 Agreement with FINRA, covering common members of the Exchange and FINRA, and that the Exchange has filed this agreement with the Commission.<sup>136</sup> The

<sup>131</sup> See Section 17(d)(1) of the Act and Rule 17d-2 thereunder. 15 U.S.C. 78q(d)(1); and 17 CFR 240.17d-2. The Commission notes that it is not approving the Regulatory Contract.

<sup>132</sup> See NOM Approval Order, *supra* note 129; Nasdaq Registration Approval Order, *supra* note 50, at notes 112 and 113 and accompanying text; Amex Approval Order, *supra* note 129; and ISE Registration Approval Order, *supra* note 129, at Section III(D)(2).

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> Rule 17d-2 provides that any two or more SROs may file with the Commission a plan for allocating among such SROs the responsibility to receive regulatory reports from persons who are members or participants of more than one of such SROs to examine such persons for compliance, or to enforce compliance by such persons, with specified provisions of the Act, the rules and regulations thereunder, and the rules of such SROs, or to carry out other specified regulatory functions with respect to such persons. 17 CFR 240.17d-2.

<sup>136</sup> See Securities Exchange Act Release No. 59101 (December 15, 2008) (File No. 4-575.)

<sup>124</sup> See, e.g., Equity Rules 4121, 4631, 6955.

<sup>125</sup> 15 U.S.C. 78f(b)(1).

<sup>126</sup> 15 U.S.C. 78f(b)(6) and (b)(7).

<sup>127</sup> See Notice, *supra* note 3, 73 FR at 69692.

<sup>128</sup> The Commission notes that the Equity Rules provide that:

proposed 17d-2 agreement allocates to FINRA regulatory responsibility, with respect to common members, as follows:

- FINRA will process and act upon all applications submitted on behalf of allied persons, partners, officers, registered personnel and any other person required to be approved by the rules of both the Exchange and FINRA or associated with common members thereof. Upon request, FINRA will advise the Exchange of any changes of allied members, partners, officers, registered personnel and other persons required to be approved by the rules of both the Exchange and FINRA.

- FINRA will investigate common members of the Exchange and FINRA for violations compliance with federal securities laws, rules and regulations, and rules of the Exchange that have been certified by BX as identical or substantially similar to a FINRA rule.

- FINRA will enforce compliance by common members with federal securities laws, rules and regulations, and rules of the Exchange that have been certified by the Exchange as identical or substantially similar to FINRA rules.

### 3. Minor Rule Violation Plan

The Commission approved the Exchange's Minor Rule Violation Plan ("MRVP") in 1989.<sup>137</sup> The MRVP specifies those uncontested minor rule violations with sanctions not exceeding \$2,500 that would not be subject to the provisions of Rule 19d-1(c)(1) under the Act<sup>138</sup> requiring that an SRO promptly file notice with the Commission of any final disciplinary action taken with respect to any person or organization.<sup>139</sup> The Exchange's MRVP includes the policies and procedures included in Equity Rule 9216(b), "Procedure for Violations under Plan Pursuant to SEC Rule 19d-1(c)(2)," and the rule violations included in Equity Rule IM-9216, "Violations Appropriate for Disposition Under Plan Pursuant to SEC

Rule 19d-1(c)(2)." The Commission notes that the Exchange proposes to add to its MRVP the list of rules set forth in Equity Rule IM-9216, which rules are the same as those listed in Nasdaq's IM-9216.<sup>140</sup>

The Commission finds that the Exchange's MRVP is consistent with Sections 6(b)(1), 6(b)(5) and 6(b)(6) of the Act, which require, in part, that an exchange have the capacity to enforce compliance with, and provide appropriate discipline for, violations of the rules of the Commission and of the exchange.<sup>141</sup> In addition, because Equity Rule 9216(b) will offer procedural rights to a person sanctioned for a violation listed in Equity Rule IM-9216, the Commission believes that the Exchange's rules provide a fair procedure for the disciplining of members and associated persons, consistent with Section 6(b)(7) of the Act.<sup>142</sup>

The Commission also finds that the proposal to include the rules listed in Equity Rule IM-9216 in the MRVP is consistent with the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Act, as required by Rule 19d-1(c)(2) under the Act,<sup>143</sup> because it should strengthen the Exchange's ability to carry out its oversight and enforcement responsibilities as an SRO in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation.

In approving the proposed change to the Exchange's MRVP, the Commission in no way minimizes the importance of compliance with Exchange rules and all other rules subject to the imposition of fines under the MRVP. The Commission believes that the violation of any SRO rules, as well as Commission rules, is a serious matter. However, the Exchange's MRVP provides a reasonable means of addressing rule violations that do not rise to the level of requiring formal disciplinary proceedings, while providing greater flexibility in handling certain violations. The Commission expects that the Exchange will conduct surveillance with due diligence and make a determination based on its findings, on a case-by-case basis, whether a fine of more or less than the recommended amount is appropriate for a violation under the MRVP or whether

a violation requires a formal disciplinary action under the Exchange's Equity Rule 9200 Series.

### IV. Exemption From the Requirement To Register as a SIP

As described above, BX Equities LLC will be delegated the authority to act as a SIP for quotations and transaction information related to securities traded on the BX Equities Market and any trading facilities operated by BX Equities LLC. In the SIP Exemption Request Letter,<sup>144</sup> the Exchange, on behalf of BX Equities LLC, requested that the Commission grant BX Equities LLC a permanent exemption from the requirement under Section 11A(b) of the Act and Rule 609 thereunder that a securities information processor acting as an exclusive processor register with the Commission.<sup>145</sup> For the reasons discussed below, the Commission grants the requested exemption, subject to the conditions specified in this Order.

#### A. Overview

BX Equities LLC is jointly owned by the Exchange and its parent corporation, NASDAQ OMX. BX Equities LLC has been established for the purpose of operating an Exchange facility for the trading of cash equity securities. Pursuant to the proposed rule change approved in this Order, the Operating Agreement has been amended to provide that management of BX Equities LLC is vested solely in the Exchange. In addition, the Exchange will delegate the performance of certain of its market functions to BX Equities LLC with respect to the quoting and trading of cash equity securities, including the authority to act as a securities information processor for quoting and trading information related to cash equity securities traded on the BX Equities Market and any trading facilities operated by BX Equities LLC. Because BX Equities LLC will be engaging, on an exclusive basis on behalf of the Exchange, in collecting, processing, or preparing for distribution or publication information with respect to transactions or quotations on, or effected or made by means of, a facility of the Exchange, it will be an exclusive processor required to register pursuant to Section 11A(b) of the Act. Nevertheless, as further described in the SIP Exemption Request Letter, the Exchange and BX Equities LLC believe that the purposes of Section 11A(b) of

<sup>137</sup> See Securities Exchange Act Release No. 26737 (April 17, 1989), 1989 WL 550708 (File No. SR-BSE-88-2) ("MRVP Order").

<sup>138</sup> 17 CFR 240.19d-1(c)(1).

<sup>139</sup> The Commission adopted amendments to paragraph (c) of Rule 19d-1 to allow SROs to submit for Commission approval plans for the abbreviated reporting of minor disciplinary infractions. See Securities Exchange Act Release No. 21013 (June 1, 1984), 49 FR 23829 (June 8, 1984). Any disciplinary action taken by an SRO against any person for violation of a rule of the SRO which has been designated as a minor rule violation pursuant to such a plan filed with the Commission will not be considered "final" for purposes of Section 19(d)(1) of the Act, 78 U.S.C. 78s(d), if the sanction imposed consists of a fine not exceeding \$2,500 and the sanctioned person has not sought an adjudication, including a hearing, or otherwise exhausted his administrative remedies.

<sup>140</sup> See Equity Rule IM-9216. The Exchange represented that these rules are in addition to existing provisions of the MRVP that remain in effect with respect to the Exchange's Boston Options Exchange facility. See Notice, *supra* note 3, 73 FR at 69690.

<sup>141</sup> 15 U.S.C. 78f(b)(1), 78f(b)(5) and 78f(b)(6).

<sup>142</sup> 15 U.S.C. 78f(b)(7).

<sup>143</sup> 17 CFR 240.19d-1(c)(2).

<sup>144</sup> See SIP Exemption Request Letter, *supra* note 6.

<sup>145</sup> 15 U.S.C. 78k-1(b). Rule 609 under the Act, 17 CFR 242.609, requires that the registration of a securities information processor be on Form SIP, 17 CFR 249.1001.

the Act are not served by requiring BX Equities LLC to register as an exclusive processor under Section 11A(b) of the Act, because Section 11A(b) subjects a registered securities information processor to a regulatory regime to which the BX Equities Market will be subject in all material respects as a facility of a registered national securities exchange.

#### B. Discussion

Sections 11A(b)(1) and (2) of the Act and Rule 609 thereunder (formerly Rule 11Ab2-1) provide that a securities information processor<sup>146</sup> that is acting as an exclusive processor<sup>147</sup> register with the Commission by filing an application for registration on Form SIP. Section 11A(b)(1) of the Act and Rule 609(c) thereunder allow the Commission, by rule or order, to conditionally or unconditionally exempt any securities information processor from any provision of Section 11A(b) of the Act or the rules or regulations thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of Section 11A(b).<sup>148</sup>

In its release adopting Rule 609, the Commission provides a framework for the consideration of exemption requests pursuant to Section 11A(b)(1) of the Act.<sup>149</sup> Specifically, the Commission indicates that the need for registration of an exclusive processor should be considered in respect of Sections

11A(b)(1), (b)(3) and (b)(5) and Sections 17(a) and (b) of the Act, insofar as they provide a framework for the surveillance and regulation of registered securities information processors. The Commission stated that any application for an exemption from registration should show not only how such exemption would be consistent with the statutory purposes discussed in the release, but also should demonstrate why, by virtue of the applicant's organization, operation or other characteristics, the applicant should be exempted from registration, the requirements of Section 11A(b) and the Commission's authority under Sections 17(a) and 17(b) of the Act.<sup>150</sup>

The Commission believes that BX Equities LLC will be acting as an exclusive processor as defined in Section 3(a)(22)(B) of the Act because it will engage on an exclusive basis on behalf of the Exchange, in collecting, processing, or preparing for distribution or publication information with respect to transactions or quotations on, or effected or made by means of, a facility of the Exchange. Further, BX Equities LLC, in carrying out market functions of the Exchange, will operate (and will be regulated) as a facility of the Exchange, which is a national securities exchange registered under Section 6 of the Act and the rules and regulations thereunder.<sup>151</sup> In the SIP Exemption Request Letter, the Exchange represents that BX Equities LLC will not perform any exclusive processor functions other than in its capacity as a facility for the Exchange.<sup>152</sup>

As discussed below, with respect to its operation as a facility of a registered national securities exchange, BX Equities LLC already will be subject to regulation and Commission oversight under the Act as a facility of a registered exchange.<sup>153</sup> Oversight and regulation of registered exchanges encompass and exceed the oversight and regulation to

which BX Equities LLC will be subject pursuant to registration under Section 11A(b)(1) of the Act and the rules and regulations thereunder. Accordingly, the Commission believes that registration of BX Equities LLC as an exclusive processor under Section 11A(b)(1) of the Act with respect to those functions that it will carry out as a facility of the Exchange would not further the purposes of the Act.

#### 1. Denial of Access to Services Provided by a Securities Information Processor or a National Securities Exchange

Section 11A(b)(5)(A) of the Act (1) requires a registered securities information processor to promptly file notice with the Commission if the processor prohibits or limits any person in respect of access to services offered, directly or indirectly, by the processor, and (2) provides that any such prohibition or limitation will be subject to Commission review, on its own motion or upon application by any person aggrieved.<sup>154</sup> If the prohibition or limitation is reviewed, the Commission shall dismiss the proceeding if it finds (after notice and opportunity for a hearing) that such prohibition or limitation is consistent with the provisions of the Act and the rules and regulations thereunder and that such person has not been discriminated against unfairly. If the Commission does not make such a finding, or if it finds that such prohibition or limitation imposes any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, the Commission shall set aside the prohibition or limitation and require the securities information processor to permit such person access to services offered by the processor.<sup>155</sup>

BX Equities LLC, however, will be subject to similar Commission regulation and oversight pursuant to Sections 6(b)(7), 6(d), 19(d), and 19(f) of the Act with respect to its activities as a facility of the Exchange.<sup>156</sup> Section 19(d)(1) requires, in part, that an exchange promptly file notice with the Commission if the exchange prohibits or limits any person in respect to access to services offered by such exchange or member thereof.<sup>157</sup> Any such action for which the exchange must file notice is subject to Commission review.<sup>158</sup>

<sup>146</sup> Section 3(a)(22) of the Act, 15 U.S.C. 78c(a)(22)(A), defines the term securities information processor to mean any person engaged in the business of (i) collecting, processing, or preparing for distribution or publication, or assisting, participating in, or coordinating the distribution or publication of, information with respect to transactions in or quotations for any security (other than an exempted security) or (ii) distributing or publishing (whether by means of a ticker tape, a communications network, a terminal display device, or otherwise) on a current and continuing basis, information with respect to such transactions or quotations.

<sup>147</sup> Under Section 3(a)(22)(B) of the Act, 15 U.S.C. 78c(a)(22)(B), an exclusive processor is defined as any securities information processor or self-regulatory organization which, directly or indirectly, engages on an exclusive basis on behalf of any national securities exchange or registered securities association, or any national securities exchange or registered securities association which engages on an exclusive basis on its own behalf, in collecting, processing, or preparing for distribution or publication any information with respect to (i) transactions or quotations on or effected or made by means of any facility of such exchange or (ii) quotations distributed or published by means of any electronic system operated or controlled by such association.

<sup>148</sup> See 15 U.S.C. 78k-1(b)(1) and 17 CFR 242.609(c).

<sup>149</sup> See Securities Exchange Act Release No. 11673 (September 23, 1975), 40 FR 45422 (October 2, 1975) (adopting Commission Rule 11Ab2-1, which has been redesignated as Rule 609).

<sup>150</sup> *Id.* at 45423.

<sup>151</sup> Section 3(a)(2) of the Act, 15 U.S.C. 78c(a)(2), defines the term facility, with respect to an exchange, to include its premises, tangible or intangible property whether on the premises or not, any right to use 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.

<sup>152</sup> SIP Exemption Request Letter, *supra* note 6.

<sup>153</sup> The definition of an exchange under the Act includes "the market facilities maintained by such exchange." See Section 3(a)(1) of the Act, 15 U.S.C. 78c(a)(1). The functions and operation of a national securities exchange encompass the collection, processing, and dissemination of information related to securities trading.

<sup>154</sup> See 15 U.S.C. 78k-1(b)(5)(A).

<sup>155</sup> See Section 11A(b)(5)(B) under the Act, 15 U.S.C. 78k-1(b)(5)(B).

<sup>156</sup> 15 U.S.C. 78f(b)(7) and (d) and 78s(d) and (f).

<sup>157</sup> 15 U.S.C. 78s(d)(1).

<sup>158</sup> 15 U.S.C. 78s(d)(2). See also Section 19(f) of the Act, 15 U.S.C. 78s(f).

Section 19(f) of the Act,<sup>159</sup> among other things, allows the Commission to set aside an SRO's prohibition or limitation with respect to access to services offered by the SRO if the Commission finds that the prohibition or limitation imposes any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Section 6(b)(7) of the Act provides that the rules of an exchange, among other things, must provide a fair procedure for the prohibition or limitation by the exchange of any person with respect to access to services offered by the exchange or a member thereof.<sup>160</sup>

Section 6(d) of the Act<sup>161</sup> requires, among other things, that a national securities exchange that initiates a proceeding to determine whether to prohibit or limit a person's access to services offered by the exchange notify the person of the specific grounds for the prohibition or limitation and provide an opportunity to be heard. In addition, Section 6(d) provides that an exchange's determination to prohibit or limit a person's access to the exchange's services must be supported by a statement setting forth the specific grounds on which the prohibition or limitation is based.

The Commission therefore believes that regulation of the Exchange as a national securities exchange provides for equivalent regulation and Commission oversight of actions that BX Equities LLC may take in its capacity as a facility to deny access to services as would be the case were it to register as an exclusive processor under Section 11A(b) of the Act.

## 2. Limitation on Activities of a Securities Information Processor or a National Securities Exchange

Section 11A(b)(6) of the Act grants the Commission authority to censure or place limitations on the activities, functions, or operations of any registered securities information processor or suspend for a period not exceeding twelve months or revoke the registration of any such processor.<sup>162</sup> Likewise, Section 19(h)(1) of the Act grants the Commission authority to suspend for a period not exceeding twelve months or revoke the registration of an exchange, or to censure or impose limitations upon the activities, functions, and operations of an

exchange.<sup>163</sup> The Commission therefore has the authority to place limitations on the activities of BX Equities LLC as a facility of a registered national securities exchange.

## 3. Access to Books and Records of a Securities Information Processor or a National Securities Exchange

Section 17(a)(1) of the Act requires that national securities exchanges and registered securities information processors make and keep for prescribed periods such records, furnish such copies thereof, and make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>164</sup> Section 17(b) of the Act requires that such records be subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission and the appropriate regulatory agency for such persons.<sup>165</sup>

The record retention and production requirements set out in Sections 17(a) and (b) of the Act therefore will be applicable to BX Equities LLC with respect to its activities as a facility of BX. Thus, requiring BX Equities LLC to register as an exclusive processor with respect to its activities as a facility of a registered exchange would serve no additional regulatory purpose in this instance.

## C. Conclusion

On the basis of the foregoing, the Commission finds that, with respect to its activities as a facility of the Exchange, granting an exemption to BX Equities LLC from the requirement to register as a securities information processor pursuant to Section 11A(b) of the Act is consistent with the public

interest, the protection of investors, and the purposes of Section 11A(b) of the Act, including maintenance of fair and orderly markets in securities and the removal of impediments to, and perfection of the mechanism of, a national market system.<sup>166</sup> This exemption is limited only to the exclusive processor activities that BX Equities LLC performs as a facility of the Exchange.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>167</sup> that the proposed rule change (SR-BSE-2008-48), as modified by Amendment Nos. 1 and 2, be, and hereby is, approved, except for inbound routing of orders from NES to the BX Equities Market, which is approved on a pilot basis through December 23, 2009.

Although the Commission's approval of the rule proposal, as amended, is final and the proposed rules are therefore effective,<sup>168</sup> it is further ordered that the operation of the BX Equities Market is conditioned on the satisfaction of the requirements below:

*A. Examination by the Commission.* The Exchange must have, and represent in a letter to the staff in the Commission's Office of Compliance Inspections and Examinations that it has, adequate surveillance procedures and programs in place to effectively regulate the BX Equities Market.

*B. 17d-2 Agreement.* An agreement pursuant to Rule 17d-2 between FINRA and the Exchange that allocates to FINRA regulatory responsibility for those matters specified above<sup>169</sup> must be approved by the Commission, or the Exchange must demonstrate that it independently has the ability to fulfill all of its regulatory obligations.

*C. Delegation Agreement.* The Exchange and BX Equities LLC must enter into the Delegation Agreement as described above.<sup>170</sup>

*It is further ordered*, pursuant to Section 11A(b) of the Act,<sup>171</sup> that BX Equities LLC shall be exempt from registering as a securities information

<sup>163</sup> 15 U.S.C. 78s(h)(1). See also Sections 19(h)(2), (h)(3), and (h)(4) of the Act, 15 U.S.C. 78s(h)(2), (h)(3), and (h)(4).

<sup>164</sup> 15 U.S.C. 78q(a). The Commission has promulgated rules pursuant to Section 17(a) of the Act that apply to national securities exchanges, but not registered securities information processors. See, e.g., Rule 17a-1 under the Act, 17 CFR 240.17a-1 (requiring in part a national securities exchange to preserve, for a period of not less than five years, the first two in an easily accessible place, at least one copy of all documents that are made or received by it in the course of its business as such and in the conduct of its self-regulatory activity, and to furnish copies of such records to any representative of the Commission upon request). Form SIP, the application for registration of a securities information processor, does require that a securities information processor provide the Commission with certain information relating to its business organization, financial information, operational capability, and access to services. 17 CFR 249.1001.

<sup>165</sup> 15 U.S.C. 78q(b).

<sup>166</sup> The Commission may grant this exemption pursuant to delegated authority. 17 CFR 200.30-3(49).

<sup>167</sup> 15 U.S.C. 78s(b)(2).

<sup>168</sup> As noted above, inbound routing of orders from NES to the BX Equities Market, which is part of the Rule Proposal, is approved on a pilot basis through December 23, 2009.

<sup>169</sup> See *supra* notes 104 through 110 and accompanying text, notes 135 to 136 and accompanying text.

<sup>170</sup> See *supra* notes 30 to 38 and accompanying text.

<sup>171</sup> 15 U.S.C. 78k-1(b).

<sup>159</sup> 15 U.S.C. 78s(f).

<sup>160</sup> 15 U.S.C. 78f(b)(7). Section 6(d)(2), 15 U.S.C. 78f(d)(2), provides procedural requirements for any such proceeding by an exchange.

<sup>161</sup> 15 U.S.C. 78f(d).

<sup>162</sup> 15 U.S.C. 78k-1(b)(6).

processor, subject to the conditions specified in this order.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>172</sup>

**Florence E. Harmon,**

*Acting Secretary.*

[FR Doc. E8-31094 Filed 12-30-08; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-59148; File No. SR-DTC-2008-12]

### Self-Regulatory Organizations; The Depository Trust Company; Order Approving Proposed Rule Change As Amended To Increase Liquidity Resources

December 23, 2008.

#### I. Introduction

On August 26, 2008, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) and on September 9, 2008, and on September 30, 2008, amended proposed rule change SR-DTC-2008-12 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).<sup>1</sup> Notice of the proposal was published in the **Federal Register** on October 21, 2008.<sup>2</sup> The Commission received no comment letters. For the reasons discussed below, the Commission is approving the proposed rule change, as amended.

#### II. Description

The proposed rule change seeks to increase the liquidity resources of DTC to ensure it has sufficient liquidity to cover the failure of a financial family of affiliated DTC Participants (“Affiliated Family”).<sup>3</sup> An Affiliated Family means a Participant that controls another Participant or other Participants and each Participant that is under the control of the controlling Participant. For purposes of this definition, “control” means the direct or indirect ownership of more than 50% of the voting securities or other voting interests of an entity.<sup>4</sup>

To ensure that DTC is able to complete its settlement obligations each day in the event of a Participant’s inability to settle with DTC, DTC currently maintains liquidity resources of \$2.5 billion composed of a \$600 million all-cash Participants Fund and a committed line of credit in the amount of \$1.9 billion with a consortium of banks. DTC’s committed line of credit was recently increased from \$1.4 billion. Given that financial firms have become increasingly interdependent, DTC recognizes that there is a possibility of “contagion” among several related Participants. Financial problems at one Participant may impact the stability of another related Participant, potentially causing both to fail simultaneously. Because of concerns about this potential, DTC and its regulators have agreed that DTC should increase its available liquidity resources so that DTC would be able to withstand the failure of a financial family of affiliated DTC Participants.<sup>5</sup> To do so, DTC will (i) increase by \$700 million the total cash deposits to DTC’s all-cash Participants Fund so that the aggregate amount of the required cash deposits to DTC’s Participant Fund plus the required preferred stock investments of Participants will be increased to \$1.3 billion from \$600 million and (ii) limit the aggregate maximum net debit cap<sup>6</sup> for any Affiliated Family to \$3 billion.

The following variables are currently used in the determination of each Participant’s required Participant’s Fund deposit:

- (1) The six largest intraday net debit peaks for a Participant over a rolling 60-business day period.
- (2) Minimum Fund Deposit: \$10,000.
- (3) Fund Size: \$600 Million.

DTC will continue to employ these variables to calculate the first \$600 million of the required \$1.3 billion Fund. The remaining \$700 million will be allocated proportionately among the Affiliated Families whose aggregate net

debit caps per family exceed \$2.3 billion.<sup>7</sup> An Affiliated Family whose net debit cap exceeds \$2.3 billion would be required to contribute a portion of the remaining \$700 million calculated by dividing the amount by which the Affiliated Family’s net debit cap exceeds \$2.3 billion by the sum of the amounts by which each Affiliated Family’s net debit cap exceeds \$2.3 billion.<sup>8</sup> Once an Affiliated Family’s additional Participant’s Fund requirement has been established, DTC will allocate this sum among the Participants comprising the Affiliated Family in proportion to each Participant’s adjusted net debit cap.<sup>9</sup> This algorithm will be systematically used to calculate the allocations for the Participants of each Affiliated Family, unless each of the Participants that comprise an Affiliated Family provides DTC with written instructions to allocate the aggregate net debit cap differently. While the Participants of an Affiliated Family may give instructions to reapportion their net debit caps among themselves, they cannot reallocate to any one Participant a debit cap that is greater than the DTC system calculated net debit cap for that Participant.

#### III. Discussion

Section 19(b) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds in DTC’s custody or control or for which it is responsible.<sup>10</sup> The Commission believes that DTC’s rule change is consistent with this Section because it should help assure the safeguarding of securities and funds in DTC’s custody or

<sup>5</sup> The Commission is the primary federal regulator of DTC as a clearing agency. DTC is also a limited purpose trust company established under New York Banking Law and a state member bank of the Federal Reserve System. As such, the The Federal Reserve Bank of New York (FRBNY) and the New York State Department of Banking also have regulatory authority over DTC.

<sup>6</sup> In order to ensure that timely settlement can be completed in the event of a failure to settle by the Participant with the largest settlement obligation, DTC by sets debit limits (called net debit caps) for each Participant. A Participant’s net debit is limited throughout the processing day to a net debit cap that is the lesser of four amounts: (1) An amount based on the average of the three largest net debits that the Participant incurred over a rolling 70 business day period, (2) an amount, if any, determined by the Participant’s settling bank, (3) an amount, if any, determined by DTC, or (4) \$1.8 billion.

<sup>7</sup> This amount is based on DTC’s practice of maintaining a liquidity cushion of \$200 million between its largest net debit cap and its liquidity resources (*i.e.*, DTC’s current liquidity of \$2.5 billion minus the \$200 liquidity cushion it maintains).

<sup>8</sup> DTC will adjust the net debit caps of the Participants that comprise an Affiliated Family so that the aggregate affiliated net debit cap does not exceed \$3 billion. Currently 18 Affiliate Families consisting of 57 DTC Participants will be subject to these Affiliated Family provisions. Thirteen Affiliated Families will be required to reduce their overall Net debit caps.

<sup>9</sup> The proposed DTC Affiliated Family Algorithm can be viewed on the Commission’s Web site at <http://www.sec.gov/rules/sro/dtc/2008/34-58757.pdf> and at DTC’s Web site at [http://www.dtc.com/downloads/legal/rule\\_filings/2008/dtc/2008-12.pdf](http://www.dtc.com/downloads/legal/rule_filings/2008/dtc/2008-12.pdf).

<sup>10</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>172</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> Securities Exchange Act Release No. 58757A (October 14, 2008), 73 FR 62578.

<sup>3</sup> DTC currently has 332 Participants, most of which are broker-dealers or banks with one Participant account. Large integrated organizations, however, typically have several “legal entities” with each being DTC Participants (*e.g.*, a bank custodian entity and a separate securities firm entity).

<sup>4</sup> Under this definition, DTC currently has 47 Affiliated Families.