

both NYSE and FINRA or NYSE Amex and FINRA. Accordingly, the Plan promotes efficiency by reducing costs to Common Members. Furthermore, because FINRA, NYSE, and NYSE Amex will coordinate their regulatory functions in accordance with the Plan, the Plan should promote investor protection and the public interest.

In particular, the Commission notes that, under the proposed Plan, FINRA, NYSE, and NYSE Amex have allocated regulatory responsibility for Common Rules to the extent that such responsibilities involve member firm regulation. The Plan also sets forth those areas for which NYSE and NYSE Amex will retain regulatory responsibility, including: examinations of conduct or actions by a Common Member covered by NYSE-only or NYSE Amex-only rules and/or by related Federal laws or regulations; surveillance, investigation, and enforcement with respect to conduct or action relating to trading on or through the systems and facilities of NYSE or NYSE Amex and conduct otherwise covered by NYSE-only or NYSE Amex-only rules, as well as whether such conduct may constitute a violation of Federal laws or regulations; processing of applications for trading licenses or other membership in NYSE or NYSE Amex; and qualification and registration of member firm personnel to effect transactions or work on the floor of NYSE or NYSE Amex pursuant to such SRO's rules.<sup>27</sup>

In addition, the proposed Plan provides that NYSE and NYSE Amex will retain regulatory responsibility for the application of any Common Rule as it pertains to matters other than member firm regulation, including matters relating to such SRO's retained responsibilities as set forth in the Plan (the "Non-Exclusive Common Rules"). The Non-Exclusive Common Rules are specifically annotated in the List of Common Rules and include those rules for which FINRA, NYSE, and NYSE Amex will each bear their respective regulatory responsibilities, consistent with the scope of the 17d-2 Plan. Such rules are "non-exclusive" in the sense that they may relate to member firm regulation (for which FINRA would assume regulatory responsibility) as well as matters other than member firm regulation (for which NYSE or NYSE Amex would retain regulatory responsibility). Accordingly, NYSE and NYSE Amex will each bear responsibility for the application of their Non-Exclusive Common Rules

<sup>27</sup> See paragraphs 2(d)(i)-(iv) and (e)(i)-(iv) of the proposed 17d-2 Plan.

concerning their particular regulatory responsibilities.

According to the Plan, whenever any Party seeks to make a change to any of its rules that are Common Rules, before filing a proposed rule change with the Commission, it will inform the other Parties of the intended change to determine whether the other Parties will propose a conforming change to its version of the Common Rule. If the Parties do not agree to propose conforming changes, the Parties agree to file with the Commission an amendment to the 17d-2 Plan to delete such rule from the list of Common Rules.<sup>28</sup> Finally, the proposed Plan requires the Parties annually (or more frequently if required by changes in the rules of a Party) to confirm in writing the accuracy of the list of Common Rules.<sup>29</sup> This provision ensures that the Parties keep the Common Rules up-to-date vis-à-vis the other Parties and should facilitate the ability of the Parties to accurately administer their responsibilities under the proposed Plan consistent with the scope of the Plan declared effective by the Commission herein.

The proposed Plan also requires the Parties to share information on a number of matters, including, for example, financial and operational matters of Common Members, third-party complaints, and disciplinary actions.<sup>30</sup> The Commission believes that the information-sharing provisions contained in the proposed Plan fosters cooperation and coordination among the Parties, thereby promoting investor protection and removing impediments to the development of a national market system.

Finally, the Plan permits any Party to terminate the Plan at any time, subject to 180 days written notice to the other Parties and subject to Commission approval.<sup>31</sup>

#### V. Conclusion

This Order gives effect to the Plan filed with the Commission in File No. 4-587. The Parties shall notify all members affected by the Plan of their rights and obligations under the Plan.

*It is therefore ordered*, pursuant to Section 17(d) of the Act,<sup>32</sup> that the Plan, made by and among NYSE, NYSE Regulation, NYSE Amex, and FINRA, that is contained in File No. 4-587 and

<sup>28</sup> See paragraph 2(a) of the proposed 17d-2 Plan.

<sup>29</sup> See paragraph 2(c) of the proposed 17d-2 Plan.

<sup>30</sup> See paragraph 5 of the proposed 17d-2 Plan.

<sup>31</sup> See paragraph 14 of the proposed 17d-2 Plan. The Commission notes that, as reflected in paragraph 14, Commission approval is required for any Party to terminate its participation in the Plan.

<sup>32</sup> 15 U.S.C. 78q(d).

filed pursuant to Rule 17d-2, is hereby approved and declared effective.

*It is therefore ordered* that NYSE and NYSE Amex are relieved of those responsibilities allocated to FINRA under the Plan in File No. 4-587.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>33</sup>

**Florence E. Harmon,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-60405; File No. 4-546]

### Joint Industry Plan; Order Approving the National Market System Plan Relating to Options Order Protection and Locked/Crossed Markets Submitted by the Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.

July 30, 2009.

#### I. Introduction

The proposed Options Order Protection and Locked/Crossed Market Plan ("Proposed Plan") was filed jointly, pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934 ("Act") ("Regulation NMS") ("Rule 608"),<sup>1</sup> by the International Securities Exchange, LLC ("ISE") and NYSE Arca, Inc. ("NYSE Arca") on September 13, 2007 and September 18, 2007, respectively, with the Securities and Exchange Commission ("Commission").<sup>2</sup> On December 11, 2007, ISE and NYSE Arca separately filed Amendment No. 1 to the Proposed Plan.<sup>3</sup> On April 24, 2008, and April 17, 2008, ISE and NYSE Arca, respectively, filed Amendment No. 2 to the Proposed Plan.<sup>4</sup> On November 10,

<sup>33</sup> 17 CFR 200.30-3(a)(34).

<sup>1</sup> 17 CFR 242.608.

<sup>2</sup> See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated September 12, 2007 ("ISE Letter 1"); and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated September 14, 2007 ("NYSE Arca Letter 1").

<sup>3</sup> See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated December 10, 2007; and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated December 10, 2007.

<sup>4</sup> Amendment No. 2 superseded Amendment No. 1 and replaced it in its entirety. See letter from

2008 and October 31, 2008, ISE and NYSE Arca, respectively, filed Amendment No. 3 to the Proposed Plan.<sup>5</sup> On April 30, 2008, May 8, 2008, June 18, 2008, June 18, 2008, and July 9, 2008, respectively, Chicago Board Options Exchange, Incorporated (“CBOE”), The NASDAQ Stock Market LLC (“Nasdaq”), American Stock Exchange LLC (“Amex”) (f/k/a NYSE Alternext US LLC, “NYSE Alternext,” n/k/a NYSE Amex LLC, “NYSE Amex”), Philadelphia Stock Exchange, Incorporated (n/k/a NASDAQ OMX PHLX, Inc., “Phlx”), and Boston Stock Exchange, Inc. (“BSE”) (n/k/a NASDAQ OMX BX, Inc., “BX” and together with ISE, NYSE Arca, CBOE, Nasdaq, Amex, and Phlx, the “Proposing Exchanges”) filed with the Commission the Proposed Plan.<sup>6</sup> On November 25, 2008, November 26, 2008, December 2, 2008, December 4, 2008, and December 5, 2008, CBOE, NYSE Alternext, BSE, Phlx, and Nasdaq, respectively, filed Amendment No. 1 to the Proposed Plan.<sup>7</sup> On April 2, 2009, a detailed

Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated April 16, 2008; and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated April 16, 2008.

<sup>5</sup> See letter from Michael J. Simon, General Counsel, ISE, to Florence Harmon, Acting Secretary, Commission, dated November 7, 2008 (“ISE Letter 2”); and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Florence Harmon, Acting Secretary, Commission, dated October 30, 2008 (“NYSE Arca Letter 2”).

<sup>6</sup> In their respective filings of the Proposed Plan, Amex, BSE, CBOE, Nasdaq, and Phlx incorporated the changes made by ISE and NYSE Arca in Amendment No. 2. See letters from Jeffrey P. Burns, Vice President and Associate General Counsel, Amex, to Nancy M. Morris, Secretary, Commission, dated June 17, 2008 (“Amex Letter 1”); Bruce Goodhue, Chief Regulatory Officer, BSE, to Florence Harmon, Acting Secretary, Commission, dated July 8, 2008 (“BSE Letter 1”); Edward J. Joyce, President and Chief Operating Officer, CBOE, to Nancy M. Morris, Secretary, Commission, dated April 29, 2008 (“CBOE Letter 1”); Jeffrey S. Davis, Vice President and Deputy General Counsel, The NASDAQ OMX Group, Inc., to Nancy M. Morris, Secretary, Commission, dated May 7, 2008 (“Nasdaq Letter 1”); and Richard S. Rudolph, Vice President and Counsel, Phlx, to Nancy M. Morris, Secretary, Commission, dated June 17, 2008 (“Phlx Letter 1”).

<sup>7</sup> In their respective Amendment No. 1 to the Proposed Plan, BSE, CBOE, NYSE Alternext, Phlx, and Nasdaq made changes identical to those made by ISE and NYSE Arca in Amendment No. 3. See letters from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Florence Harmon, Acting Secretary, Commission, dated November 25, 2008 (“CBOE Letter 2”); Jeffrey P. Burns, Managing Director, NYSE Alternext, to Florence Harmon, Acting Secretary, Commission, dated November 25, 2008 (“Amex Letter 2”); John Katovich, Vice President, BSE, to Florence Harmon, Acting Secretary, Commission, dated December 1, 2008 (“BSE Letter 2”); Richard S. Rudolph, Vice President and Counsel, Phlx, to Florence Harmon, Acting Secretary, Commission, dated December 3, 2008 (“Phlx Letter 2”); and Jeffrey S. Davis, Vice President and Deputy General Counsel, The

summary of the Proposed Plan was published for comment in the **Federal Register**.<sup>8</sup>

The Commission received one comment on the Proposed Plan.<sup>9</sup>

This order approves the Proposed Plan, with changes as the Commission deems necessary or appropriate, thus authorizing CBOE, ISE, Nasdaq, BX, Phlx, Amex, and NYSE Arca to act jointly to implement the Proposed Plan, as modified herein, as a means of facilitating a national market system in accordance with the requirements of Section 11A of the Act.<sup>10</sup>

## II. Background

### A. Section 11A of the Act

In 1975, Congress directed the Commission, through the enactment of Section 11A of the Act,<sup>11</sup> to facilitate the establishment of a national market system to link together the individual markets that trade securities. Congress found the development of a national market system to be in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure fair competition among the exchange markets.<sup>12</sup> Section 11A(a)(3)(B) of the Act directs the Commission, “by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities.”<sup>13</sup> The Commission’s approval of a national market system plan is conditioned upon

NASDAQ OMX Group, Inc., to Florence Harmon, Acting Secretary, Commission, dated December 4, 2008 (“Nasdaq Letter 2”).

<sup>8</sup> Securities Exchange Act Release No. 59647 (March 30, 2009), 74 FR 15010 (File No. 4-546) (“Proposed Plan Notice”). The full text of the Proposed Plan submitted by the Proposing Exchanges, is available on the Commission’s Web site at <http://sec.gov/rules/sro/nms/nmsarchive/nms2007.shtml#4-546>, at each Proposing Exchange, and at the Commission’s Public Reference Room.

<sup>9</sup> Letter from John C. Nagel, Managing Director & Deputy General Counsel, Citadel Investment Group L.L.C. (“Citadel”) to Nancy M. Morris, Secretary, Commission, dated July 18, 2008 (“Citadel Letter”). The Citadel Letter cited to Citadel’s comments made in a letter from John C. Nagel, Managing Director & Deputy General Counsel, Citadel to Nancy M. Morris, Secretary, Commission, dated July 15, 2008 (Petition for Rulemaking to Address Excessive Access Fees in the Options Markets) (“Petition for Rulemaking”).

<sup>10</sup> 15 U.S.C. 78k-1. See also 17 CFR 242.608(b)(2). The approved Options Order Protection and Locked/Crossed Market Plan, which incorporates the changes the Commissions deems necessary or appropriate, is attached here as *Appendix A* and is referred to herein as the “Options Linkage Plan.”

<sup>11</sup> 15 U.S.C. 78k-1.

<sup>12</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>13</sup> 15 U.S.C. 78k-1(a)(3)(B).

a finding that the proposed plan is “necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanism of, a national market system, or otherwise in furtherance of the purposes of the Act.”<sup>14</sup>

### B. Current Plan

Currently, the Proposing Exchanges are signatories to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Current Plan”). The Current Plan is a national market system plan linking its participants. The Commission approved the Current Plan on July 28, 2000.<sup>15</sup> Subsequently, both Pacific Exchange, Inc. (n/k/a “NYSE Arca”) and Phlx submitted proposed amendments to the Current Plan to become participants to the Current Plan. These proposed amendments were approved on November 16, 2000.<sup>16</sup> On February 5, 2004, BSE’s proposed amendment to become a participant to the Current Plan became effective.<sup>17</sup> Further, Nasdaq’s proposed amendment to become a participant to the Current Plan became effective on March 21, 2008.<sup>18</sup>

The Current Plan requires its participants to avoid, absent reasonable justification and during normal market conditions, trading at a price inferior to that displayed on another market (“trade-through”).<sup>19</sup> The Current Plan provides for several exceptions to trade-through liability, including, among other things, systems malfunction, failure of the receiving market to respond to an incoming order within 30 seconds, failure of the market traded through to complain within the specified time period, complex trades, trading rotations, and non-firm quotations on the market that was traded through.<sup>20</sup> The Current Plan also provides a mechanism by which a member of a participating exchange

<sup>14</sup> 17 CFR 242.608(b)(2).

<sup>15</sup> See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (File No. 4-429).

<sup>16</sup> See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) (File No. 4-429) and 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000) (File No. 4-429).

<sup>17</sup> See Securities Exchange Act Release No. 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004) (File No. 4-429).

<sup>18</sup> See Securities Exchange Act Release No. 57545 (March 21, 2008), 73 FR 16394 (March 27, 2008) (File No. 4-429).

<sup>19</sup> Section 8(c) of the Current Plan.

<sup>20</sup> Section 8(c)(iii) of the Current Plan.

could seek satisfaction if a customer order is traded through.<sup>21</sup>

Under the Current Plan, its participants agree that the dissemination of “locked” or “crossed” markets should be avoided, and, if their members lock or cross a market, they should take remedial actions to unlock or uncross such market.<sup>22</sup> Further, the Current Plan contains provisions to address trade comparison, clearing, trading halts, non-firm quotations, and administration of the Current Plan.<sup>23</sup> Except with respect to the addition of new participants and the withdrawal of current participants, any proposed change to the Current Plan must be approved unanimously by its participants.<sup>24</sup>

The participating exchanges comply with the requirements of the Current Plan, including the prohibition against trade-throughs, by utilizing a stand alone system (“Linkage Hub”) to send and receive specific order types. The Linkage Hub is a centralized data communications network that electronically links the options exchanges to one another. The Options Clearing Corporation (“OCC”) operates the Linkage Hub.<sup>25</sup>

There are three defined order types under the Current Plan that its participants could route through the Linkage Hub to limit trade-throughs: orders represented by eligible market makers on behalf of customers (“Principal Acting as Agent Orders” or “P/A Orders”);<sup>26</sup> orders for the principal accounts of market makers and specialists (“Principal Orders”);<sup>27</sup> and orders intended to satisfy trade-through liabilities (“Satisfaction Orders”).<sup>28</sup> Non-market-maker broker-dealers do not have access to the Linkage Hub.

### C. Proposed Plan

The Proposing Exchanges are now seeking approval of an alternative linkage plan, the Proposed Plan. As described in more detail below, the Proposed Plan would not require a central linkage mechanism akin to the Current Plan’s Linkage Hub, and would introduce certain new features to

linkages between options markets, including an Intermarket Sweep Order (“ISO”) similar to that available for NMS stocks under Regulation NMS.<sup>29</sup>

### III. Discussion

As discussed above, in 1975, Congress directed the Commission, through the enactment of Section 11A of the Act,<sup>30</sup> to facilitate the development of a national market system consistent with the objectives of the Act. In particular, Section 11A(a)(3)(B) of the Act<sup>31</sup> authorizes the Commission “by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities.” Rule 608 establishes the procedures for filing, amending, and approving a national market system plan. Approval of such a plan is conditioned upon a finding that the proposed plan “is necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act.”<sup>32</sup>

After careful review, the Commission has determined to approve the Proposed Plan, pursuant to Section 11A(a)(3)(B) of the Act<sup>33</sup> and Rule 608 thereunder,<sup>34</sup> with changes set forth herein as the Commission has deemed necessary and appropriate.<sup>35</sup> Specifically, the Commission finds that changes to the Proposed Plan set forth herein are necessary and appropriate in the public interest. The Commission further finds that the Options Linkage Plan is in furtherance of the purposes of the Act in that it requires the protection of the best priced displayed quotes and avoidance and reconciliation of locked and crossed markets, and thus is necessary and appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and

perfect the mechanisms of, a national market system.<sup>36</sup>

The Commission believes that Proposed Plan’s decentralized structure will allow the Proposing Exchanges to take advantage of new technology that allow for efficient routing and executions. The Proposed Plan will give the Proposing Exchanges greater flexibility for order handling as it would allow the exchanges to utilize private linkages, instead of requiring each Proposing Exchange to connect to, and participate in the maintenance of, a centralized hub. In addition, the Proposed Plan would permit the use of ISOs in the options markets. As such, the Proposed Plan would allow the Proposing Exchanges to move towards the market structure approved by the Commission for NMS stocks under Regulation NMS.<sup>37</sup> The Commission believes that the Options Linkage Plan will allow the Proposing Exchanges to update the way in which they accomplish effective quote protection and locked and crossed market reconciliation. For the reasons described above, the Commission believes that these provisions of the Options Linkage Plan will provide benefits to the options markets, including the Proposing Exchanges and market participants generally.

In its comment letter on the Proposed Plan, Citadel referenced the comments it made with regard to access fees in the options markets in its Petition for Rulemaking.<sup>38</sup> There, Citadel encouraged the Commission to institute a rulemaking proceeding to limit the fees that options exchanges may charge non-members to obtain access to quotations.<sup>39</sup> Commission staff is currently considering Citadel’s petition.

#### A. Order Protection

##### 1. Requirement of Reasonable Policies and Procedures

The Options Linkage Plan requires each Participant<sup>40</sup> to establish,

<sup>36</sup> 17 CFR 242.608(b)(2).

<sup>37</sup> See *supra* note 29.

<sup>38</sup> See Citadel Letter, *supra* note 9.

<sup>39</sup> See Petition for Rulemaking, *supra* note 9.

<sup>40</sup> The Options Linkage Plan defines “Participant” to mean an Eligible Exchange whose participation in the plan has become effective pursuant to Section 3(c) of the Options Linkage Plan. See Section 2(15) of the Options Linkage Plan. The Options Linkage Plan defines “Eligible Exchange” to mean a national securities exchange registered with the Commission in accordance with Section 6(a) of the Act that, among other things, is a Participant Exchange in OCC (as that term is defined in Section VII of the OCC by-laws) and is a party to the OPRA Plan (as that term is described in Section I of the OPRA Plan). “OPRA Plan” means the plan filed by the Options Price Reporting Authority with the Commission pursuant to Section 11A(a)(1)(C)(iii) of the Act and approved by the

<sup>21</sup> Section 8(c)(ii) of the Current Plan.

<sup>22</sup> Section 7(a)(i)(C) of the Current Plan.

<sup>23</sup> Sections 5, 9, and 10 of the Current Plan.

<sup>24</sup> Section 5(c)(i) of the Current Plan.

<sup>25</sup> See ISE Letter 2 and NYSE Arca Letter 2, *supra* note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, *supra* note 7.

<sup>26</sup> Sections 2(16)(a) and 7(a)(ii)(A), (B) of the Current Plan.

<sup>27</sup> Sections 2(16)(b) and 7(a)(ii)(C) of the Current Plan.

<sup>28</sup> Sections 2(16)(c) and 7(a)(ii)(D) of the Current Plan.

<sup>29</sup> See Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005) (File No. S7-10-04) (“NMS Release”); 17 CFR 242.600 *et seq.*

<sup>30</sup> 15 U.S.C. 78k-1.

<sup>31</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>32</sup> 17 CFR 242.608.

<sup>33</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>34</sup> 17 CFR 242.608.

<sup>35</sup> The Commission has modified the Proposed Plan to amend Section 7 of the Proposed Plan relating to the implementation date of the plan (see *infra* notes 140-143 and accompanying text).

maintain, and enforce written policies and procedures as approved by the Commission that are reasonably designed to prevent Trade-Throughs in that Participant's market in Eligible Options Classes.<sup>41</sup> A "Trade-Through"<sup>42</sup> is defined as a transaction in an option series, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer. A "Protected Bid" or a "Protected Offer"<sup>43</sup> means a bid or offer in an option series that is displayed by an Eligible Exchange, is disseminated pursuant to the OPRA Plan, and is the Best Bid or Best Offer of an Eligible Exchange. A "Best Bid" or "Best Offer"<sup>44</sup> means the highest bid price or the lowest offer price communicated by a member of an Eligible Exchange to any broker-dealer or to any customer at which such member is willing to buy or sell, either as principal or agent.

The Options Linkage Plan also requires each Participant to agree to conduct surveillance of its market on a regular basis to ascertain the effectiveness of the policies and procedures to prevent Trade-Throughs and to take prompt action to remedy deficiencies in such policies and procedures.<sup>45</sup>

As is the case currently for NMS stocks under Regulation NMS,<sup>46</sup> the Commission believes the Options Linkage Plan's policies and procedures-based approach to preventing Trade-Throughs in options is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets, and is consistent with Section 11A(a)(1)(C) of the Act.<sup>47</sup> The requirement in Section 5(a)(i) of the Options Linkage Plan is virtually identical to the requirement in Rule 611(a) of Regulation NMS. The Commission expects the Participants in the Options Linkage Plan will establish, maintain, and enforce written policies and procedures comparable to those established, maintained and enforced by the market centers subject to Rule

Commission and declared effective as of January 22, 1976, as from time to time amended. See Section 2(14) of the Options Linkage Plan. For the definitions of "Trade-Through," "Best Bid" or "Best Offer," "Locked Market," and "Crossed Market," see *infra* notes 42, 44, and 119 and accompanying texts.

<sup>41</sup> Section 5(a)(i) of the Options Linkage Plan.

<sup>42</sup> Section 2(21) of the Options Linkage Plan.

<sup>43</sup> Section 2(17) of the Options Linkage Plan. Protected Bid and Protected Offer, together are referred to herein as "Protected Quotation." See Section 2(18) of the Options Linkage Plan.

<sup>44</sup> Sections 2(1) and 2(2) of the Options Linkage Plan.

<sup>45</sup> Section 5(a)(ii) of the Options Linkage Plan.

<sup>46</sup> See Rule 611(a) of Regulation NMS (17 CFR 242.611(a)).

<sup>47</sup> 15 U.S.C. 78k-1(a)(1)(C).

611(a). The Commission believes that a policies and procedures-based approach to preventing Trade-Throughs in options is reasonable given the increasingly high volume of trading in options, and the latencies and other discrepancies in the delivery and receipt of quotation data. The requirement of written policies and procedures, as well as the responsibility assigned to Participants to regularly surveil to ascertain the effectiveness of their procedures and take prompt remedial steps, is designed to achieve the objective of eliminating all Trade-Throughs that reasonably can be prevented, while also recognizing the inherent difficulties of eliminating Trade-Through transactions that, despite a Participant's reasonable efforts, may occur.

The Commission believes that each Participant's policies and procedures must enable it to monitor, on a real-time basis, the Protected Quotations displayed by Eligible Exchanges so as to determine the prices at which the Participant can and cannot execute trades. In addition, the Commission believes that a Participant's policies and procedures must establish objective standards and parameters governing its use of the exceptions set forth in Section 5(b) of the Options Linkage Plan, discussed below, and expects each Participant's order-handling and trading systems to be programmed in accordance with these policies and procedures. Finally, the Participant must take such steps as are necessary to enable it to enforce its policies and procedures effectively. For example, the Commission believes that Participants will need to establish procedures such as regular exception reports to evaluate their trading and order-routing practices. The Commission believes that each Participant Exchange will need to examine such reports to affirm that its policies and procedures have been followed by its personnel and properly coded into its systems and, if not, to promptly identify the reasons and take remedial action.<sup>48</sup>

Participants' obligations under the Options Linkage Plan to maintain and enforce policies and procedures reasonably designed to prevent Trade-Throughs is reinforced by the Options Linkage Plan's explicit assignment of responsibility to Participants to surveil to ascertain the effectiveness of their policies and procedures. Participants cannot merely establish policies and procedures that may be reasonable when created and assume that such policies and procedures continue to

satisfy the requirements of the Options Linkage Plan. Rather, the Commission believes that Participants must regularly assess the continuing effectiveness of their procedures and take prompt action when needed to remedy deficiencies. In particular, Participants must engage in regular surveillance to determine whether Trade-Throughs are occurring without an applicable exception and whether they have failed to implement and maintain policies and procedures that would have reasonably prevented such Trade-Throughs. Further, this requirement is an important element of a Participant's obligations under Rule 608(c) of Regulation NMS, which require that each self-regulatory organization, absent reasonable justification or excuse, enforce compliance with any national market system plan by its members and persons associated with its members.<sup>49</sup>

## 2. Exceptions to Trade-Throughs

The Options Linkage Plan provides exceptions for certain transactions from the prohibition against Trade-Throughs.<sup>50</sup> The Options Linkage Plan also provides that, if a Participant relies on an exception, it would be required to establish, maintain, and enforce written policies and procedures reasonably designed to assure compliance with the terms of the exception.<sup>51</sup> Except for the proposed exception for stopped orders and price improvement,<sup>52</sup> the exceptions in the Options Linkage Plan correspond to trade-through exceptions found in either the Current Plan or in Regulation NMS.<sup>53</sup> The Options Linkage Plan includes the following exceptions from the prohibition against Trade-Throughs: system issues;<sup>54</sup> trading rotations;<sup>55</sup> crossed markets;<sup>56</sup> intermarket sweep orders;<sup>57</sup> quote flickering;<sup>58</sup> non-firm quotes;<sup>59</sup> complex trades;<sup>60</sup> customer stopped orders;<sup>61</sup> stopped orders and price

<sup>49</sup> 17 CFR 242.608(c).

<sup>50</sup> See Proposed Plan Notice at 15012, *supra* note 8, for a more detailed description of the proposed Trade-Through exceptions.

<sup>51</sup> Section 5(a)(i) of the Options Linkage Plan.

<sup>52</sup> Section 5(b)(x) of the Options Linkage Plan.

<sup>53</sup> Rule 611 of Regulation NMS, known also as the Order Protection Rule, governs trade-through liability for NMS Stocks. See 17 CFR 242.611.

<sup>54</sup> Section 5(b)(i) of the Options Linkage Plan.

<sup>55</sup> Section 5(b)(ii) of the Options Linkage Plan.

<sup>56</sup> Section 5(b)(iii) of the Options Linkage Plan.

For the definition of a "Crossed Market," see *infra* note 119 and accompanying text.

<sup>57</sup> Section 5(b)(iv)-(v) of the Options Linkage Plan.

<sup>58</sup> Section 5(b)(vi) of the Options Linkage Plan.

<sup>59</sup> Section 5(b)(vii) of the Options Linkage Plan.

<sup>60</sup> Section 5(b)(viii) of the Options Linkage Plan.

<sup>61</sup> Section 5(b)(ix) of the Options Linkage Plan.

<sup>48</sup> See NMS Release at 37535, *supra* note 29.

improvement;<sup>62</sup> and benchmark trades.<sup>63</sup>

The Commission believes these exceptions will permit a workable intermarket price protection structure for the options market, and are consistent with the principle of price protection. As discussed below, the Commission finds that each of these exceptions is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>64</sup> and believes each assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>65</sup>

*System Issues:*<sup>66</sup> This exception, similar to an exception in the Current Plan, permits a Participant to trade through a Protected Quotation if the Eligible Exchange displaying the Protected Quotation that was traded through was experiencing a failure, material delay, or malfunction of its systems or equipment when the Trade-Through occurred. This exception gives Participants a “self-help” remedy if another Eligible Exchange repeatedly fails to provide an immediate response to incoming orders attempting to access its quotes. As the Commission stated in approving a parallel exception for stocks under Regulation NMS, the Eligible Exchange receiving an order can only be held responsible for its own turnaround time (*i.e.*, from the time it first received an order to the time it transmits a response to the order). Accordingly, the routing exchange will be required to develop policies and procedures that allow for any potential delays in transmission not attributable to the receiving exchange. This exception also covers any failure or malfunction of an Eligible Exchange’s systems or equipment, as well as any material delay.<sup>67</sup>

Participants will need to establish specific objective parameters governing their use of this “self-help” exemption as part of their reasonable policies and procedures. The Commission believes, for example, a single failure to respond within one second generally will not justify future bypassing of another Eligible Exchange’s quotations. Many failures to respond within one second in a short time period, in contrast, clearly will warrant use of the exception. The Commission believes that a Participant making use of this exception must notify the non-responding Eligible

Exchange immediately after (or at the same time as) electing this exception pursuant to reasonable and objective standards contained in its policies and procedures in order to alert the non-responding Eligible Exchange that the Participant intends to make use of this exception with respect to the non-responding Eligible Exchange’s quotes.<sup>68</sup>

The Commission believes that a Participant should be entitled to bypass an away market’s quotations if that market fails to respond to incoming orders attempting to access a displayed quote. The Commission believes that this exception will provide Participants with the necessary flexibility for dealing with problems that occur on an away market during the trading day. Further, the Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>69</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>70</sup>

*Trading Rotations:*<sup>71</sup> This exception, which is carried over from the Current Plan<sup>72</sup> and similar to an exception available for NMS stocks under Regulation NMS,<sup>73</sup> permits a Participant to trade through a Protected Quotation disseminated by an Eligible Exchange during a trading rotation. Options exchanges use a trading rotation to open an option for trading or reopen an option after a trading halt.

As noted by the Participants, the trading rotation is effectively a single price auction to price the option,<sup>74</sup> and there are no practical means to include prices on other exchanges in that auction.<sup>75</sup> As such, the Commission emphasizes that the exception will not permit a Participant to declare a trading halt merely to be able to circumvent the operation of the Options Linkage Plan’s Trade-Through provisions upon reopening; instead, the Commission believes a Participant must conduct, pursuant to its rules, a formalized and transparent process for executing orders during reopening after a trading halt that involves the queuing and ultimate

execution of multiple orders at a single equilibrium price. In addition, a Participant must have formally declared a trading halt pursuant to its rules. Therefore, the Commission finds that it is reasonable to include this as an exception to the general prohibition on Trade-Throughs as it is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>76</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>77</sup>

*Crossed Markets:*<sup>78</sup> This exception permits a Participant to trade through a Protected Quotation when the market is crossed, and corresponds to an exception for NMS stocks under Regulation NMS.<sup>79</sup> A Crossed Market occurs when a Protected Bid is higher than a Protected Offer in a given options class. The Commission believes that it is appropriate to permit executions without regard to Trade-Throughs in a Crossed Market because allowing such transactions should permit the market to quickly resolve any unintentional crosses. For the foregoing reasons, the Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>80</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>81</sup>

*Intermarket Sweep Orders:*<sup>82</sup> The Options Linkage Plan includes two exceptions from the prohibition against Trade-Throughs for certain transactions involving ISOs. These two exceptions correspond to the exceptions relating to ISOs for NMS stocks under Regulation NMS.<sup>83</sup> First, the Options Linkage Plan permits a Participant to execute orders marked as ISOs even when the Participant is not at the national best bid or offer (“NBBO”). Second, a Participant is permitted to execute a transaction when such transaction is not at the NBBO, provided it simultaneously “sweeps” all better priced Protected Quotations by routing an ISO to execute against the full displayed size of any Protected Quotation that was traded through.

<sup>68</sup> *Id.*

<sup>69</sup> 17 CFR 242.608(b)(2).

<sup>70</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>71</sup> Section 5(b)(ii) of the Options Linkage Plan.

<sup>72</sup> See Section 8(c)(iii)(E) of the Current Plan.

<sup>73</sup> See Rule 611(b)(3) of Regulation NMS under the Act (17 CFR 242.611(b)(3)).

<sup>74</sup> See ISE Letter 2 and NYSE Arca Letter 2, *supra* note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, *supra* note 7.

<sup>75</sup> See ISE Letter 2 and NYSE Arca Letter 2, *supra* note 5; see also Amex Letter 2, BSE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, *supra* note 7.

<sup>76</sup> 17 CFR 242.608(b)(2).

<sup>77</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>78</sup> Section 5(b)(iii) of the Options Linkage Plan.

<sup>79</sup> See Rule 611(b)(4) of Regulation NMS (17 CFR 242.611(b)(4)).

<sup>80</sup> 17 CFR 242.608(b)(2).

<sup>81</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>82</sup> Section 5(b)(iv) and (v) of the Options Linkage Plan.

<sup>83</sup> See Rule 611(b)(5) and (6) of Regulation NMS (17 CFR 242.611(b)(5) and (6)).

<sup>62</sup> Section 5(b)(x) of the Options Linkage Plan.

<sup>63</sup> Section 5(b)(xi) of the Options Linkage Plan.

<sup>64</sup> 17 CFR 242.608(b)(2).

<sup>65</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>66</sup> Section 5(b)(i) of the Options Linkage Plan.

<sup>67</sup> See NMS Release at 37535, *supra* note 29.

An ISO is defined as a limit order for an options series that, when routed to an Eligible Exchange, is identified as an Intermarket Sweep Order and, simultaneously with the routing of the order, one or more additional orders, as necessary, are routed to execute against the full displayed size of any Protected Bid, in the case of a limit order to sell, or any Protected Offer, in the case of a limit order to buy, for the options series with a price that is superior to the limit price of the order.<sup>84</sup> Any such additional orders would also be marked as ISOs.

The availability of ISOs will allow the Participants to access multiple price levels simultaneously displayed on the same or multiple markets, without violating the prohibition against Trade-Throughs. As the Commission stated with respect to ISOs for stocks under Regulation NMS, the Commission believes that allowing a Participant to immediately execute an order identified as an ISO when that exchange is not at the NBBO is fully consistent with the principle of protecting the best displayed prices because the exception is premised on the condition that the market participant sending the ISO has already attempted to access all better-priced Protected Quotations up to their displayed size. Consequently, there is no reason why a Participant that receives an ISO while displaying an inferior-priced quotation should be required to delay an execution of the order.<sup>85</sup> This exception should help to ensure more efficient and faster executions.

The second ISO Trade-Through exception, under subparagraph (b)(v) of Section 5 of the Options Linkage Plan, should benefit market participants in their ability to handle orders efficiently. For example, market participants should be able to use this exception to more efficiently execute block trades one or more minimum price increments away from the NBBO. So long as ISOs are simultaneously routed to execute against better-priced Protected Quotation on other markets, the block order could be executed contemporaneously with the routing of the ISOs.

The Commission notes that Section 5(c) of the Options Linkage Plan requires Participants to take reasonable steps to establish that ISOs are properly routed in an attempt to execute against all applicable Protected Quotations.

For the reasons stated above, the Commission finds that the exception from Trade-Through liability when an

exchange or market participants sends an ISO is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>86</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>87</sup>

*Quote Flickering:*<sup>88</sup> Subparagraph (b)(vi) of Section 5 of the Options Linkage Plan sets forth an exception for flickering quotations, and corresponds to an exception for NMS stocks under Regulation NMS.<sup>89</sup> It excepts a transaction if the Eligible Exchange displaying the Protected Quotation that was traded through had displayed, within one second prior to execution of the Trade-Through, a Best Bid or Best Offer, as applicable, for the options series with a price that was equal or inferior to the price of the Trade-Through transaction.

As the Commission stated with respect to the similar exception for stocks under Regulation NMS,<sup>90</sup> this exception thereby provides a “window” to address false indications of Trade-Throughs that in actuality are attributable to rapidly moving quotations. It should also reduce the number of instances in which a Participant must alter its normal trading procedures and route orders to other trading centers to comply with the Options Linkage Plan. The exception is thereby intended to promote more workable intermarket price protection. The Commission finds it is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>91</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>92</sup>

*Non-Firm Quotes:*<sup>93</sup> This exception, which is carried over from the Current Plan,<sup>94</sup> permits a Participant to trade through a Protected Quotation that was “Non-Firm.”<sup>95</sup> “Non-Firm” is defined to mean, with respect to Quotations in an Eligible Options Class, that members of a Participant are relieved of their obligations under that Participant’s firm quote rule in that Eligible Options Class.<sup>96</sup>

The Commission believes that Participants should not be required to protect the price of an away market when that market identifies its quotes as “Non-Firm.” The Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>97</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>98</sup>

*Complex Trades:*<sup>99</sup> This exception carries forward the complex trade exception in Section 8(c)(iii)(G) of the Current Plan<sup>100</sup> and permits a Participant to trade through a Protected Quotation if the transaction was part of a “complex trade.” The definition of “complex trade” would be implemented through rules adopted by the Participants, which would be subject to notice, comment, and Commission review pursuant to the Section 19(b) rule filing process.

Complex trades, such as those submitted by market participants under the Proposing Exchanges complex order mechanisms,<sup>101</sup> are composed of multiple transactions effected at a net price. As the Proposing Exchanges state,<sup>102</sup> it is not always practical to require each leg to be transacted at a price that does not constitute a Trade-Through, and the Commission believes that permitting an exception for transactions effected as a portion of a complex trade is appropriate. By narrowly crafting the definition of complex trades in each Participants’ rules,<sup>103</sup> the Commission believes that this exception will not undercut the general Trade-Through protections of the Options Linkage Plan, and finds it is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>104</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>105</sup>

rules require the exchange to provide notice that its quotations are Non-Firm by appending an indicator to its quotations. See, e.g., CBOE Rule 43.14(b) and NYSE Arca Rule 6.86(d)(1)(C).

<sup>97</sup> 17 CFR 242.608(b)(2).

<sup>98</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>99</sup> Section 5(b)(viii) of the Options Linkage Plan.

<sup>100</sup> Section 8(c)(iii)(G) of the Current Plan.

<sup>101</sup> See, e.g., ISE Rule 722.

<sup>102</sup> See ISE Letter 2 and NYSE Arca Letter 2, *supra* note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, *supra* note 7.

<sup>103</sup> All changes to rules of national securities exchanges are subject to notice, comment and Commission review pursuant to Section 19(b) of the Act. 15 U.S.C. 78s(b).

<sup>104</sup> 17 CFR 242.608(b)(2).

<sup>105</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>84</sup> Section 2(9) of the Options Linkage Plan.

<sup>85</sup> See NMS Release at 37523, *supra* note 29.

<sup>86</sup> 17 CFR 242.608(b)(2).

<sup>87</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>88</sup> Section 5(b)(vi) of the Options Linkage Plan.

<sup>89</sup> See Rule 611(b)(8) of Regulation NMS (17 CFR 242.611(b)(8)).

<sup>90</sup> See NMS Release at 37536, *supra* note 29.

<sup>91</sup> 17 CFR 242.608(b)(2).

<sup>92</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>93</sup> Section 5(b)(vii) of the Options Linkage Plan.

<sup>94</sup> See Section 8(c)(iii)(C) of the Current Plan.

<sup>95</sup> See Section 2(11) of the Options Linkage Plan.

<sup>96</sup> The Commission notes that, when quotations in an Eligible Options Class are Non-Firm, exchange

*Customer Stopped Orders:*<sup>106</sup> This exception permits a Participant to trade through a Protected Quotation if the trade executed a "stopped order." The exception requires that the "stopped order" be for the account of a Customer;<sup>107</sup> that the Customer agreed to the specified price on an order-by-order basis; and that the price of the Trade-Through was, for a stopped buy order, lower than the national Best Bid in the options series at the time of execution, or, for a stopped sell order, higher than the national Best Offer in the options series at the time of execution. This exception corresponds to the customer stopped order exception under Regulation NMS.<sup>108</sup>

The Commission recognizes that the use of stopped orders is a valuable tool, particularly for the execution of large orders.<sup>109</sup> The Commission believes that this narrowly-drawn exception would give market participants the ability to execute large Customer orders over time at a price agreed upon by a Customer, even though the price of the option may change before the order is executed in its entirety, without undermining the general principles of price protection under the Options Linkage Plan. For these reasons, the Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>110</sup> and assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>111</sup>

*Stopped Orders and Price Improvement:*<sup>112</sup> This exception permits a Participant to trade through a Protected Quotation if the transaction that constituted the Trade-Through was the execution by a Participant of an order that is stopped at a price that did not constitute a Trade-Through at the time of the stop. This exception allows a Participant to seek price improvement for an order, even if the market moves in the interim, and the transaction ultimately is effected at a price that would trade through the then currently-displayed market. The rules of several of the Proposing Exchanges currently

contain provisions relating to price improvement mechanisms.<sup>113</sup>

These price improvement mechanisms offer price improvement to orders received by the exchange during a specified period of time ("auction"). During this auction period, the NBBO could move from where it was when the order was received. However, the exchange is only required to guarantee a price no worse than the NBBO at the time the order was received. Thus, following the auction, an execution could result in a Trade-Through if the NBBO improves from the time the order was received although, had the order been executed at the time of receipt, the execution would not have resulted in a Trade-Through.

This exception would allow a Participant to seek price improvement for an order, even if the market moves in the interim, and the transaction ultimately is effected at a price that would trade through the then currently-displayed market. By allowing this exception, the Commission expects that Participants would be able to continue to use price improvement mechanisms, thereby offering market participants potentially better-priced executions. The Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>114</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>115</sup>

*Benchmark Trades:*<sup>116</sup> This exception permits a Participant to trade through a Protected Quotation if the trade was executed at a price not based directly or indirectly on the quoted price of an options series at the time of execution and for which the material terms were not reasonably determinable at the time of the commitment to make the trade.

This exception allows a "benchmark order" and corresponds to an exception for NMS stocks under Rule 611 of Regulation NMS.<sup>117</sup> A common example of a benchmark order for NMS stocks is a volume-weighted average price, or "VWAP," order. The Commission notes that none of the Proposing Exchanges currently permit these types of options trades, and any Participant seeking to make use of this exception would be

required to submit a proposed rule change which would be subject to notice, comment and Commission review under Section 19(b) of the Act. The Commission finds that this exception is in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets, and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C) of the Act.<sup>118</sup>

#### B. Locked and Crossed Markets

The Options Linkage Plan also addresses Locked and Crossed Markets.<sup>119</sup> The requirements in the Options Linkage Plan relating to Locked and Crossed Markets are virtually identical to those applicable to market centers for NMS stock under Regulation NMS.<sup>120</sup>

Specifically, the Options Linkage Plan requires each Participant to establish, maintain, and enforce written rules that require their members reasonably to avoid displaying Locked and Crossed Markets.<sup>121</sup> Participants would also be required to establish, maintain, and enforce written rules reasonably designed to assure the reconciliation of Locked and Crossed Markets.<sup>122</sup> Finally, the Options Linkage Plan would provide that Participants must establish, maintain, and enforce written rules that prohibit their members from engaging in a pattern or practice of displaying Locked and Crossed Markets, subject to exceptions as may be contained in the Participants' rules, as approved by the Commission.<sup>123</sup>

The Commission recognizes that Section 6 of the Options Linkage Plan, by restricting Locked Markets, can prohibit the display of an order that would otherwise have been displayed and reduced the quoted spread to zero. However, as the Commission stated with respect to locked markets for stocks under Regulation NMS, the

<sup>118</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>119</sup> Section 6 of the Options Linkage Plan. A "Locked Market" is defined as a quoted market in which a Protected Bid is equal to a Protected Offer in a series of an Eligible Options Class. See Section 2(10) of the Options Linkage Plan. A "Crossed Market" is defined as a quoted market in which a Protected Bid is higher than a Protected Offer in a series of an Eligible Options Class. See Section 2(4) of the Options Linkage Plan.

<sup>120</sup> See Rule 610(d) of Regulation NMS (17 CFR 242.610(d)).

<sup>121</sup> Section 6(a) of the Options Linkage Plan.

<sup>122</sup> Section 6(b) of the Options Linkage Plan.

<sup>123</sup> Section 6(c) of the Options Linkage Plan. The Commission notes that the proposed rule changes relating to all necessary implementing rules of the Participants, including those required by Section 6 of the Options Linkage Plan, would be subject to notice, comment, and Commission review pursuant to Section 19(b) of the Act.

<sup>106</sup> Section 5(b)(ix) of the Options Linkage Plan.

<sup>107</sup> "Customer" would be defined to mean an individual or organization that is not a "Broker/Dealer." See Section 2(5) of the Options Linkage Plan.

<sup>108</sup> See Rule 611(b)(9) of Regulation NMS (17 CFR 242.611(b)(9)).

<sup>109</sup> See NMS Release at 37527, *supra* note 29.

<sup>110</sup> 17 CFR 242.608(b)(2).

<sup>111</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>112</sup> Section 5(b)(x) of the Options Linkage Plan.

<sup>113</sup> See, e.g., Securities Exchange Act Release No. 50819 (December 8, 2004), 69 FR 75093 (December 15, 2004) (SR-ISE-2003-06) (approving rules implementing ISE's Price Improvement Mechanism under ISE Rule 723).

<sup>114</sup> 17 CFR 242.608(b)(2).

<sup>115</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>116</sup> Section 5(b)(xi) of the Options Linkage Plan.

<sup>117</sup> See Rule 611(b)(7) of Regulation NMS (17 CFR 242.611(b)(7)).



Commission believes that Locked Markets may not actually represent two market participants willing to buy and sell at the same price. Instead, a locking market participant may not truly be willing to trade at the displayed locking price, but chooses to lock rather than execute against the already-displayed quotation to receive a liquidity rebate. The Commission believes that giving priority to the first-displayed Protected Bid or Protected Offer, particularly when it includes a public customer's order, will encourage price discovery and contribute to fair and orderly markets.<sup>124</sup>

The Options Linkage Plan is designed to ensure that the display of locked and crossed markets would be restricted, while also recognizing that locked and crossed markets do occur accidentally and cannot always be avoided. Thus, the Options Linkage Plan requires that the Participants have written rules that are reasonably designed to assure the reconciliation of any lock or cross. Further, the Options Linkage Plan expressly prohibits a pattern or practice of locking or crossing away markets.

In addition, the Options Linkage Plan would allow exceptions to its general Locked and Crossed Markets provision as might be contained in a given Participant's rules. As with all proposed rule changes of national securities exchanges, such rule changes would be subject to notice, comment and Commission review under Section 19(b)(1) of the Act.<sup>125</sup> The Commission believes that these provisions are designed to ensure that the display of Locked and Crossed Markets will be limited and that any such display will be promptly reconciled.

For the reasons stated above, the Commission finds that the Options Linkage Plan's provisions relating to Locked and Crossed Markets are in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>126</sup> and believes they assure fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>127</sup>

#### C. Joining the Proposed Plan

Any national securities exchange would be eligible to become a Participant by executing a copy of the Options Linkage Plan and providing each Participant with a copy of such executed Options Linkage Plan<sup>128</sup> if it is: (1) Registered with the Commission

in accordance with Section 6(a) of the Act; (2) a Participant Exchange in OCC;<sup>129</sup> and (3) a party to the OPRA Plan.<sup>130</sup> Further, any such national securities exchange wishing to become a Participant would be required to file an amendment to the Options Linkage Plan by executing a copy of the Options Linkage Plan and filing such executed Options Linkage Plan to the Commission.<sup>131</sup> Such amendment would be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder.<sup>132</sup> The Commission finds that this process for joining the Options Linkage Plan is in the public interest,<sup>133</sup> and believes it is consistent with Section 11A(a)(1)(C) because it is designed to ensure that reasonable procedures are in place to permit additional exchanges to also participate in the Options Linkage Plan.<sup>134</sup>

#### D. Withdrawal From the Proposed Plan

Any Participant would be able to withdraw from the Options Linkage Plan at any time by providing not less than 30 days' prior written notice to each of the other Participants of such intent to withdraw.<sup>135</sup> To withdraw, such Participant also would be required to effect an amendment to the Options Linkage Plan by submitting such amended Options Linkage Plan to the Commission for approval.<sup>136</sup> In submitting the amended Options Linkage Plan to the Commission, the Participant proposing to withdraw from the Options Linkage Plan would be required to state how the Participant plans to accomplish, by alternate means, the goal of the Options Linkage Plan regarding limiting Trade-Throughs of prices on other exchanges trading the same options classes.<sup>137</sup> Such withdrawal from the Options Linkage Plan would be effective when the amendment is approved by the

Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder. Upon the effectiveness of such withdrawal, the withdrawing Participant would have no further rights or obligations under the Options Linkage Plan.

The Commission finds that these requirements for withdrawal from the Options Linkage Plan are in the public interest, appropriate for the protection of investors and the maintenance of fair and orderly markets,<sup>138</sup> and believes it assures fair competition among exchange markets, consistent with Section 11A(a)(1)(C).<sup>139</sup>

#### E. Implementation

The Proposed Plan states that the "[Participants] shall implement [the plan] \* \* \* no later than February 27, 2009; provided that, unless the [Commission] otherwise authorizes, the [Participants] shall not implement [the plan] until all Eligible Exchanges either (1) have become parties to [the plan] and the [Commission] has approved all necessary implementing rules or (2) have developed the ability to accept and execute incoming Intermarket Sweep Orders."<sup>140</sup>

To provide clarity to market participants regarding the implementation date of the plan, the Commission, after consultation with the Proposing Exchanges, has modified the Proposed Plan to change the implementation date in Section 7 from February 27, 2009 to August 31, 2009. In addition, the Commission notes that all seven options exchanges<sup>141</sup> have joined in filing the Proposed Plan with the Commission, and each has submitted proposed rule changes pursuant to Section 19(b) of the Act to modify its rules to comply with the Options Linkage Plan.<sup>142</sup> The Commission believes that the provision that would permit the plan to be implemented if an Eligible Exchange "developed the ability to accept and execute incoming Intermarket Sweep Orders," even if such exchange had not become a party to the plan is no longer necessary because all seven options exchanges have joined the Options

<sup>129</sup> For a definition of a "Participant Exchange," see Section VII of the OCC by-laws.

<sup>130</sup> For more information on who is a party to the OPRA Plan, see Section I of the OPRA Plan.

<sup>131</sup> Section 4(b) of the Options Linkage Plan.

<sup>132</sup> *Id.* These requirements are identical to those contained in the Current Plan. See Sections 4(c)(i) and 5(c) of the Current Plan. The Current Plan also requires that an eligible exchange pay a fee to join the Current Plan. See Section 4(c)(i)(iv) of the Current Plan. The Options Linkage Plan does not require an Eligible Exchange to pay a fee to join the Options Linkage Plan.

<sup>133</sup> 17 CFR 242.608(b)(2).

<sup>134</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>135</sup> Section 3(d) of the Options Linkage Plan.

<sup>136</sup> Section 4(c) of the Options Linkage Plan.

<sup>137</sup> *Id.* These requirements are identical to those contained in the Current Plan. See Sections 4(d) and 5(c)(iii) of the Current Plan.

<sup>138</sup> 17 CFR 242.608(b)(2).

<sup>139</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>140</sup> See Section 7 of the Proposed Plan.

<sup>141</sup> That is, CBOE, ISE, Nasdaq, BX, Phlx, Amex and NYSE Arca.

<sup>142</sup> See, e.g., Securities Exchange Act Release Nos. 60014 (June 1, 2009); and 74 FR 27224 (June 8, 2009) (SR-ISE-2009-27) and 60015 (June 1, 2009); 74 FR 27375 (June 9, 2009) (SR-NYSEAmex-2009-19) which propose rules such as provisions that contain relevant definitions, an order protection rule, and a locked and crossed market rule, which correspond to the provisions in the Options Linkage Plan.

<sup>124</sup> See NMS Release at 37547, *supra* note 29.

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

<sup>126</sup> 17 CFR 242.608(b)(2).

<sup>127</sup> 15 U.S.C. 78k-1(a)(1)(C).

<sup>128</sup> Section 3(c) of the Options Linkage Plan.



Linkage Plan and therefore will, upon implementation of the Options Linkage Plan, accept and execute ISOs.

The Commission finds that these modifications to Section 7 of the Proposed Plan are necessary and appropriate and will further the purposes of the Act by providing clarity to market participants regarding the implementation of the plan while providing appropriate time to self-regulatory organizations to prepare for implementation.

With these modifications, unless the Commission otherwise authorizes, the plan may only be implemented by the Proposing Exchanges when all Proposing Exchanges' proposed rule changes containing the necessary implementing rules<sup>143</sup> have been approved by the Commission.

#### IV. Conclusion

*It is hereby ordered*, that pursuant to Section 11A(a)(3)(B) of the Act<sup>144</sup> and Rule 608 thereunder,<sup>145</sup> that the Proposed Plan submitted by CBOE, ISE, Nasdaq, BX, Phlx, Amex, and NYSE Arca, as modified herein, is approved and declared effective,<sup>146</sup> and that CBOE, ISE, Nasdaq, BX, Phlx, Amex, and NYSE Arca are authorized to act jointly to implement the Options Order Protection and Locked/Crossed Market Plan as a means of facilitating a national market system.

By the Commission.

**Florence E. Harmon,**

*Deputy Secretary.*

#### Appendix A

##### Options Order Protection and Locked/Crossed Market Plan

###### Section 1—Preamble

The Participants submit to the SEC this Plan providing a framework for order protection and addressing Locked and Crossed Markets in Eligible Options Classes. The purpose of the Plan is to enable the Participants to act jointly in establishing a framework for providing order protection and addressing Locked and Crossed Markets in Eligible Options Classes. In addition, the Plan provides for a non-exclusive method for achieving order protection and addressing Locked and Crossed Markets. The Participants will submit to the SEC for approval their respective rules that will implement the framework of the Plan. The Participants request that the SEC issue an order pursuant to Section 11A(a)(3)(B) of the Exchange Act and Rule 608 thereunder evidencing its approval of the Plan.

###### Section 2—Definitions

(1) “Best Bid” and “Best Offer” mean the highest priced Bid and the lowest priced Offer.

(2) “Bid” or “Offer” means the bid price or the offer price communicated by a member of an Eligible Exchange to any Broker/Dealer, or to any customer, at which it is willing to buy or sell, as either principal or agent, but shall not include indications of interest.

(3) “Broker/Dealer” means an individual or organization registered with the SEC in accordance with Section 15(b)(1) of the Exchange Act or a foreign broker or dealer exempt from such registration pursuant to Rule 15a-6 under the Exchange Act.

(4) “Crossed Market” means a quoted market in which a Protected Bid is higher than a Protected Offer in a series of an Eligible Class.

(5) “Customer” means an individual or organization that is not a Broker/Dealer.

(6) “Eligible Exchange” means a national securities exchange registered with the SEC in accordance with Section 6(a) of the Exchange Act that: (a) As a Participant Exchange in OCC (as that term is defined in Section VII of the OCC by-laws); (b) is a party to the OPRA Plan (as that term is described in Section I of the OPRA Plan); and (c) if the national securities exchange chooses not to become a party to this Plan, is a participant in another plan approved by the Commission providing for comparable Trade-Through and Locked and Crossed Market protection.

(7) “Eligible Options Class” means all option series overlying a security (as that term is defined in Section 3(a)(10) of the Exchange Act) or group of securities, including both put options and call options, which class is available for trading on two or more Eligible Exchanges.

(8) “Exchange Act” means the Securities Exchange Act of 1934, as amended.

(9) “Intermarket Sweep Order (ISO)” means a limit order for an options series that meets the following requirements:

(a) When routed to an Eligible Exchange, the order is identified as an ISO;

(b) Simultaneously with the routing of the order, one or more additional ISOs, as necessary, are routed to execute against the full displayed size of any Protected Bid, in the case of a limit order to sell, or any Protected Offer, in the case of a limit order to buy, for the options series with a price that is superior to the limit price of the ISO, with such additional orders also marked as ISOs.

(10) “Locked Market” means a quoted market in which a Protected Bid is equal to a Protected Offer in a series of an Eligible Options Class.

(11) “Non-Firm” means, with respect to Quotations in an Eligible Options Class, that members of a Participant are relieved of their obligations under that Participant's firm quote rule in that Eligible Options Class.

(12) “OCC” means The Options Clearing Corporation.

(13) “OPRA” means the Options Price Reporting Authority.

(14) “OPRA Plan” means the plan filed with the SEC pursuant to Section 11Aa(1)(C)(iii) of the Exchange Act, approved by the SEC and declared effective as of January 22, 1976, as from time to time amended.

(15) “Participant” means an Eligible Exchange whose participation in the Plan has become effective pursuant to Section 3(c) of the Plan.

(16) “Plan” means the plan amended and restated in this instrument as from time to time amended in accordance with its provisions.

(17) “Protected Bid” or “Protected Offer” means a Bid or Offer in an options series, respectively, that:

a. Is displayed by an Eligible Exchange;

b. Is disseminated pursuant to the OPRA Plan; and

c. Is the Best Bid or Best Offer, respectively, of an Eligible Exchange.

(18) “Protected Quotation” means a Protected Bid or Protected Offer.

(19) “Quotation” means a Bid or Offer.

(20) “SEC” means the United States Securities and Exchange Commission.

(21) “Trade-Through” means a transaction in an options series, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer.

###### Section 3—Parties to the Plan

###### (a) List of Parties

The parties to the Plan are as follows:

Boston Stock Exchange, Inc., registered as a national securities exchange under the Exchange Act and having its principal place of business at 100 Franklin Street, Boston, Massachusetts 02110.

Chicago Board Options Exchange, Incorporated, registered as a national securities exchange under the Exchange Act and having its principal place of business at 400 South LaSalle Street, Chicago, Illinois 60605.

International Securities Exchange, LLC, registered as a national securities exchange under the Exchange Act and having its principal place of business at 60 Broad Street, New York, New York 10004.

The NASDAQ Stock Market LLC, registered as a national securities exchange under the Exchange Act and having its principal place of business at One Liberty Plaza, 50th Floor, New York, New York 10006.

NASDAQ OMX PHLX, Inc., registered as a national securities exchange under the Exchange Act and having its principal place of business at 1900 Market Street, Philadelphia, Pennsylvania 19103.

NYSE Alternext US LLC, registered as a national securities exchange under the Exchange Act and having its principal place of business at 11 Wall Street, New York, NY 10005.

NYSE Arca, Inc., registered as a national securities exchange under the Exchange Act and having its principal place of business at 100 South Wacker Drive, Suite 1800, Chicago, IL 60606.

###### (b) Compliance Undertaking

By subscribing to and submitting the Plan for filing with the SEC, each Participant agrees to enforce compliance by its members with the provisions of the Plan.

###### (c) Entry of New Participants

The Participants agree that any other Eligible Exchange may become a Participant by: (i) Executing a copy of the Plan, as then in effect; (ii) providing each then-current

<sup>143</sup> See *id.*

<sup>144</sup> 15 U.S.C. 78k-1(a)(3)(B).

<sup>145</sup> 17 CFR 242.608.

<sup>146</sup> The approved Plan is attached here as Appendix A.

Participant with a copy of such executed Plan; and (iii) effecting an amendment to the Plan as specified in Section 4(b) of the Plan.

(d) *Withdrawal from the Plan*

Any Participant may withdraw from the Plan at any time by: (i) Providing not less than 30 days' prior written notice to each of the other Participants of such intent to withdraw; and (ii) effecting an amendment to the Plan as specified in Section 4(c) of the Plan. Upon the effectiveness of such withdrawal the withdrawing Participant shall have no further rights or obligations whatsoever under the Plan.

*Section 4—Amendments to the Plan*

(a) *General Amendment Authority*

Except with respect to:

(i) the addition of new Participants to the Plan; and

(ii) the withdrawal of a Plan Participant, any proposed change in, addition to, or deletion from the Plan may be effected only by means of a written amendment to the Plan that is unanimously approved by the Participants and that: (A) sets forth the change, addition or deletion; (B) is executed on behalf of each Participant; and (C) is approved by the SEC or otherwise becomes effective pursuant to Section 11A of the Exchange Act and Rule 608 thereunder.

(b) *New Participants*

With respect to new Participants, an amendment to the Plan may be effected by a new Eligible Exchange executing a copy of the Plan, as then in effect (with the only change being the addition of the new Participant's name in Section 3(a) of the Plan), and submitting such executed Plan to the SEC. Such amendment will be effective when the amendment is approved by the SEC or otherwise becomes effective pursuant to Section 11A of the Exchange Act and Rule 608 thereunder.

(c) *Withdrawal from the Plan*

A Participant seeking to withdraw from the Plan shall effect an amendment to the Plan as then in effect (with the only change being the deletion of the Participant's name in Section 3(a) of the Plan) by submitting such amended Plan to the SEC for approval. In submitting the amended Plan to the SEC, the Participant proposing to withdraw from the Plan shall state how the Participant plans to accomplish, by alternate means, the goal of the Plan regarding limiting Trade-Throughs of prices on other exchanges trading the same options classes. Such withdrawal from the Plan shall be effective when the amendment is approved by the SEC or otherwise becomes effective pursuant to Section 11A of the Exchange Act and Rule 608 thereunder.

*Section 5—Order Protection*

(a) *Order Protection*

(i) *Prevention of Trade-Throughs.* Each Participant agrees that it shall establish, maintain and enforce written policies and procedures as approved by the SEC that are reasonably designed to prevent Trade-Throughs in that Participant's market in Eligible Options Classes that do not fall within an exception set forth in paragraph (b) below, and, if relying on such exception, that are reasonably designed to assure compliance with the terms of the exception.

(ii) *Surveillance.* Each Participant agrees to conduct surveillance of its market on a regular basis to ascertain the effectiveness of the policies and procedures required by paragraph (a)(1) of this section, and to take prompt action to remedy deficiencies in such policies and procedures.

(b) *Exceptions.*

(i) The transaction that constituted the Trade-Through was effected when the Eligible Exchange displaying the Protected Quotation that was traded through was experiencing a failure, material delay, or malfunction in its systems or equipment;

(ii) The transaction traded through a Protected Quotation being disseminated by an Eligible Exchange during a trading rotation;

(iii) The transaction that constituted the Trade-Through occurred when there was a Crossed Market;

(iv) The transaction that constituted the Trade-Through was the execution of an order identified as an Intermarket Sweep Order;

(v) The transaction that constituted the Trade-Through was effected by a Participant that simultaneously routed an Intermarket Sweep Order to execute against the full displayed size of any Protected Quotation that was traded through;

(vi) The Eligible Exchange displaying the Protected Quotation that was traded through had displayed, within one second prior to execution of the Trade-Through, a Best bid or Best offer, as applicable, for the options series with a price that was equal or inferior to the price of the Trade-Through transaction;

(vii) The Protected Quotation traded through was being disseminated from an Eligible Exchange whose Quotations were Non-Firm with respect to such options series;

(viii) The transaction that constituted the Trade-Through was effected as a portion of a "complex trade," as defined in the rules of a Participant;

(ix) The transaction that constituted the Trade-Through was the execution by a Participant of an order for which, at the time of receipt of the order, a member of the Participant had guaranteed an execution at no worse than a specified price (a "stopped order"), where:

(A) The stopped order was for the account of a Customer;

(B) the Customer agreed to the specified price on an order-by-order basis; and

(C) the price of the Trade-Through was, for a stopped buy order, lower than the national Best Bid in the options series at the time of execution, or, for a stopped sell order, higher than the national Best Offer in the options series at the time of execution;

(x) The transaction that constituted the Trade-Through was the execution by a Participant of an order which was stopped at a price that did not Trade-Through another Eligible Exchange at the time of the stop; or

(xi) The transaction that constituted the Trade-Through was the execution of an order at a price that was not based, directly or indirectly, on the quoted price of the options series at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made.

(c) *Intermarket Sweep Orders.* Participants shall take reasonable steps to establish that

Intermarket Sweep Orders meet the requirements of Section 2(9) of the Plan.

*Section 6—Locked and Crossed Markets*

The Participants agree that they shall establish, maintain and enforce written rules that:

(a) Require their members reasonably to avoid displaying Locked and Crossed Markets;

(b) Are reasonably designed to assure the reconciliation of Locked and Crossed Markets; and

(c) Prohibit its members from engaging in a pattern or practice of displaying Locked and Crossed Markets;

in all cases subject to such exceptions as may be contained in the rules of a Participant approved by the Commission.

*Section 7—Implementation*

The Parties shall implement this Plan on a date upon which all Parties agree, but no later than August 31, 2009; provided that, unless the SEC otherwise authorizes, the Parties shall not implement this Plan unless all Eligible Exchanges have become parties to this Plan and the SEC has approved all necessary implementing rules.

*Section 8—Counterparts and Signatures*

The Plan may be executed in any number of counterparts, no one of which need contain all signatures of all Participants, and as many of such counterparts as shall together contain all such signatures shall constitute one and the same instrument.

*In Witness Whereof*, this Plan has been executed as of the \_\_\_\_\_ 2009 by each of the parties hereto.

CHICAGO BOARD OPTIONS EXCHANGE,  
INCORPORATED

By: \_\_\_\_\_  
Date: \_\_\_\_\_

INTERNATIONAL SECURITIES EXCHANGE,  
LLC

By: \_\_\_\_\_  
Date: \_\_\_\_\_

The NASDAQ STOCK MARKET LLC

By: \_\_\_\_\_  
Date: \_\_\_\_\_

NASDAQ OMX BX, INC.

By: \_\_\_\_\_  
Date: \_\_\_\_\_

NASDAQ OMX PHLX, Inc.

By: \_\_\_\_\_  
Date: \_\_\_\_\_

NYSE AMEX LLC

By: \_\_\_\_\_  
Date: \_\_\_\_\_

NYSE ARCA, INC.

By: \_\_\_\_\_  
Date: \_\_\_\_\_

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