

Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-NYSEAmex-2010-113 and should be submitted on or before January 10, 2011.

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

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-63539; File No. SR-BX-2010-079]

### Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing of Proposed Rule Change To Amend Chapter IV of the BOX Rules To Allow Executing Participants To Provide BOX a List of the Order Flow Providers for Which the Executing Participants Will Provide Directed Order Services

December 14, 2010.

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> notice is hereby given that on December 3, 2010, NASDAQ OMX BX, Inc. (the "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II

below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to amend Chapter IV, Section 5 (Obligations of Market Makers) of the Rules of the Boston Options Exchange Group, LLC ("BOX") to allow Executing Participants ("EP")<sup>3</sup> to provide BOX a list of the Order Flow Providers ("OFP") for which the EP will provide Directed Order services. The text of the proposed rule change is available on the Exchange's Web site at <http://nasdaqomxbx.cchwallstreet.com/NASDAQOMXBX/Filings/>, on the Commission's Web site at <http://www.sec.gov>, at the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

Under the BOX's Directed Order process, Market Makers on BOX are able to handle orders on an agency basis directed to them by OFPs. An OFP sends a Directed Order to BOX with a designation of the Market Maker to whom the order is to be directed. BOX then routes the Directed Order to the appropriate Market Maker. Under Chapter VI, Section 5(c)(ii) of the BOX Rules, a Market Maker only has two choices when he receives a Directed Order: (1) Submit the order to the PIP process; or (2) send the order back to BOX for placement onto the BOX Book.

Chapter VI, Section 5(c)(i) prohibits a Market Maker from rejecting a Directed Order. This means that upon systematically indicating its desire to accept Directed Orders, the BOX system prevents a Market Maker that receives a Directed Order from either rejecting the receipt of the Directed Order from the BOX Trading Host or rejecting the Directed Order back to the OFP who sent it. A Market Maker who desires to accept Directed Orders must systemically indicate that it is an EP whenever the Market Maker wishes to receive Directed Orders from the BOX Trading Host. If a Market Maker does not systemically indicate that it is an EP, then the BOX Trading Host will not forward any Directed Orders to that Market Maker. In such a case, the BOX Trading Host will send the order directly to the BOX Book.

The Exchange proposes to amend Chapter VI, Section 5(c)(i) (Directed Order Process) of the BOX Rules to allow EPs to provide BOX a list of OFPs for which the EP will provide Directed Order services. Under the proposal, prior to accepting any Directed Order through the Trading Host, an EP must inform BOX of the OFPs from whom it has agreed to accept Directed Orders ("Listed OFPs" or "LOFPs"). The Trading Host will then only send to the EP Directed Orders from LOFPs. In addition, unlike all other orders submitted to the BOX Trading Host, Directed Orders are not anonymous based on a pilot program discussed in BSE-2006-14.<sup>4</sup> This practice will continue under this proposed rule change because BOX proposes that the BOX Trading Host will reveal to the EP the participant ID of the OFP sending the Directed Order. Shortly after the filing of this proposed rule change, the original proposal relating to the non-

<sup>4</sup> See Securities Exchange Act Release Nos. 53516 (March 20, 2006), 71 FR 15232 (March 27, 2006) (SR-BSE-2006-14); 54082 (June 30, 2006), 71 FR 38913 (July 10, 2006) (SR-BSE-2006-29); 54469 (September 19, 2006), 71 FR 56201 (September 26, 2006) (SR-BSE-2006-38); 55139 (January 19, 2007), 72 FR 3448 (January 25, 2007) (SR-BSE-2007-01); 56014 (July 5, 2007), 72 FR 38104 (July 12, 2007) (SR-BSE-2007-31); 57195 (January 24, 2008), 73 FR 5610 (January 30, 2008) (SR-BSE-2008-04); 59311 (January 28, 2009), 74 FR 6071 (February 4, 2009) (SR-BX-2009-007); 59983 (May 27, 2009), 74 FR 26445 (June 2, 2009) (SR-BX-2009-027); 61065 (November 25, 2009), 74 FR 62860 (December 1, 2009) (SR-BX-2009-076); 61577 (February 24, 2010), 75 FR 9464 (March 2, 2010) (SR-BX-2010-017); 61929 (April 16, 2010), 75 FR 21085 (April 22, 2010) (SR-BX-2010-031) and 62366 (June 23, 2010), 75 FR 37863 (June 30, 2010) (SR-BX-2010-041).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> Capitalized terms not otherwise defined herein shall have the meanings prescribed within the BOX Rules.

anonymity of Directed Orders (BSE–2005–52) will be withdrawn.<sup>5</sup>

Upon the withdrawal of BSE–2005–52, BSE–2006–14 will automatically expire.<sup>6</sup> Therefore, concurrent with the filing of the proposal, the Exchange has proposed a new Pilot Program designed to function in exactly the same manner as under the original Pilot Program (“BSE–2006–14”)<sup>7</sup>, which clarified that Directed Orders on BOX are not anonymous. The new Pilot Program allows BOX’s current Directed Order rule and process to continue on an uninterrupted basis.<sup>8</sup> This new pilot period will afford the Commission the necessary time to consider the Exchange’s proposal to amend the BOX Rules to permit EPs to only receive Directed Orders through the Trading Host from OFPs whom the EP has designated. In the event the Commission reaches a decision with respect to the Exchange’s proposal to amend the BOX Rules before December 31, 2010, the Directed Order Process Pilot Program governing the Directed Order process on BOX will cease to be effective at the time of that decision.

#### Discretionary Service

BOX notes that in all events, whether a Market Maker elects to accept Directed Orders or chooses systematically not to accept any Directed Orders, its displayed best bid and offer are firm and accessible for automatic executions by all order submitters. In other words, the Directed Order process is a discretionary service that Market Makers may choose to provide or not, above and beyond satisfying their core market maker obligations of providing continuous two-sided firm quotations on a nondiscriminatory basis. Just as other market makers may and do choose to provide, or not, other discretionary services, such as payment for order flow, BOX Market Makers may identify the OFPs for which they may choose to

provide such discretionary service as Directed Order.<sup>9</sup>

Consistent with the fact that the Directed Order process is a discretionary service, allowing EPs to provide BOX a list of OFPs to whom it will provide Directed Order services is not only consistent with the statute<sup>10</sup>—which does not prohibit broker-dealers from determining which customer for whom it will provide a discretionary service, but also is highly desirable. As is true with respect to any discretionary service, without some control over the OFPs from whom Market Makers will accept Directed Orders, Market Makers may be expected to provide less of the service. This is specifically true with respect to the Directed Order process because the automated customer protections built into the Directed Order process, absent the ability to control the OFPs for whom it will provide the service, could and almost certainly would have the unintended consequences of creating an opportunity for Options Participants to engage in abusive practices that jeopardize the ability of all Market Makers to price improve customer orders.

An EP’s quote at the NBBO is taken down upon BOX’s receipt of a Directed Order and yet is still guaranteed as a Firm Quote for at least three seconds regardless of whether market prices change during that time (known as the Guaranteed Directed Order (“GDO”)). Because of the three second GDO, it is possible that some Options Participants, including market makers, could send large numbers of Directed Orders to EP competitors using strategies that could continually cause the EP to yield

priority (if it declines to PIP the order). This outcome is particularly problematic since, at a minimum, the EP is forced to forgo whatever time priority he may have had over his competitors at the top of the BOX Book for the given option series of the Directed Order. Moreover, the EP is also obligated to provide the GDO for at least three seconds and trade with any unexecuted Directed Order quantity (but only if no other Options Participant wants to trade with the Directed Order). Essentially this means the EP will trade with the declined Directed Order only when no one else wishes to interact with that order. Without the protection of being sent Directed Orders only from LOFPs, EPs will have to modify their risk assessment and therefore give less price improvement to everyone—or perhaps stop accepting any Directed Orders and not giving price improvement at all. This effect would significantly harm the retail investors who have benefited from the BOX price improvement system since its inception.

#### Anonymity

Under the proposal the Exchange seeks to reveal to the EP the Participant ID of the OFP sending the Directed Order.<sup>11</sup> The Market Makers must submit this Participant ID to BOX whenever the Market Maker chooses to submit the Directed Order and his Primary Improvement Order to the PIP process. However, once the Directed Order is submitted to the PIP process or the BOX Book, the Participant ID is not shown to any market participant and the identity of the OFP will be anonymous pursuant to Chapter V, Section 14(e).

A similar version of the proposed directed order process regarding anonymity has been operating successfully under the Directed Order Process Pilot Program for over four and a half years without negative effect to investors or price improvement. BOX believes that allowing the Participant ID to be revealed to the EP has had a positive influence on price improvement.<sup>12</sup> Anonymity of market participants is not required under the Exchange Act. The identification of the OFP in the Directed Order process is consistent with the requirements set forth under Section 6(b)(5) of the Exchange Act in that it will benefit the marketplace and protect investors

<sup>5</sup> See Securities Exchange Act Release No. 53357 (February 23, 2006), 71 FR 10730 (March 2, 2006) (SR–BSE–2005–52).

<sup>6</sup> See Securities Exchange Act Release No. 62366 (June 23, 2010), 75 FR 37863 (June 30, 2010) (SR–BX–2010–041).

<sup>7</sup> See also Securities Exchange Act Release No. 63540 (December 3, 2010 [sic]) (SR–BX–2010–080). The Commission notes that SR–BX–2010–080 was filed on December 13, 2010. See also *supra* note 4. BSE–2006–14 has been in effect since March 14, 2006 as the Commission solicited comments and considered its effect on price improvement. Together these Pilots have constituted the “Directed Order Process Pilot Program”.

<sup>8</sup> See Securities Exchange Act Release No. 63540 (December 3, 2010 [sic]) (SR–BX–2010–080). The Commission notes that SR–BX–2010–080 was filed on December 13, 2010.

<sup>9</sup> See Securities Exchange Act Release No. 47351 (February 11, 2003), 68 FR 8055 (February 19, 2003) (SR–NASD–2002–60). As stated in the adopting release, the New York Stock Exchange comment letter on the Primex rule proposal argued that “participants may selectively trade against agency orders alone by using a mechanism to screen out professional orders.” The Nasdaq Stock Market responded “that this feature ensures that any price improvement or enhanced liquidity opportunities be reserved for public customers, and not necessarily professional traders who could otherwise take advantage of the System’s benefits and ‘pre-empt’ the ability of a public customer to receive such benefits.” See Securities Exchange Act Release No. 47351 (February 11, 2003), 68 FR 8055, 8058 (February 19, 2003) (SR–NASD–2002–60). See generally Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (stating that the Primary Market Makers and Competitive Market Makers on the ISE “will have the ability to set parameters regarding their willingness to trade generally with a broker-dealer’s proprietary order.”).

<sup>10</sup> See Securities Exchange Act Release No. 52827 (November 23, 2005), 70 FR 72139 (December 1, 2005) (SR–PCX–2005–56) (generally approving proposal by the Pacific Exchange to “add a provision that requires Users to be given permission by DMMs in order to send a Directed Order to that DMM.”).

<sup>11</sup> See *supra* note 5.

<sup>12</sup> For example, in the month of August 2010, price improved contracts on BOX increased to an average of 204,090 per day, setting an all-time record, with total improvement to investors of \$5.4 million. From its inception to August 2010, BOX had provided investors over \$296 million of price improvement.

because it will give Market Makers the ability to identify the firms for whom it will provide this discretionary service. This proposal will allow Options Participants to make better informed decisions in determining when and how to use the Directed Order process, while also motivating Market Makers to continue to provide the high levels of price improvement available to investors.

In particular, BOX notes that the proposal is not designed to permit unfair discrimination between customers, brokers, or dealers, and satisfies the statutory mandates of Section 6(b)(5) of the Exchange Act because upon systematically indicating its desire to accept Directed Orders from LOFPs, the BOX system prevents a Market Maker that receives a Directed Order from either rejecting the receipt of the Directed Order from the BOX Trading Host or rejecting the Directed Order back to the OFP who sent it. Further, the BOX Rules guarantee equal access to the PIP and the BOX Book for customers, brokers, and dealers for those that do not wish to use the Directed Order process.

## 2. Statutory Basis

The Exchange believes that the proposal is consistent with the requirements of Section 6(b) of the Act,<sup>13</sup> in general, and Section 6(b)(5) of the Act,<sup>14</sup> in particular, in that it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism for a free and open market and a national market system and, in general, to protect investors and the public interest. In particular, the Exchange notes that anonymity of market participants is not required under the Exchange Act and believes that this proposed rule change will benefit the marketplace and protect investors because it will give Market Makers the ability to identify the firms for whom it will provide this discretionary service. This proposal will allow Options Participants to make better informed decisions in determining when and how to use the Directed Order process, while also motivating Market Makers to continue to provide the high levels of price improvement available to investors in the BOX market.

Additionally, the Exchange believes that the proposal is not designed to

permit unfair discrimination between customers, brokers, or dealers, and satisfies the statutory mandates of Section 6(b)(5) of the Exchange Act because upon systematically indicating its desire to accept Directed Orders from LOFPs, the BOX system prevents a Market Maker that receives a Directed Order from either rejecting the receipt of the Directed Order from the BOX Trading Host or rejecting the Directed Order back to the OFP who sent it. Further, the BOX Rules guarantee equal access to the PIP and the BOX Book for customers, brokers, and dealers for those that do not wish to use the Directed Order process.

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

The Exchange has neither solicited nor received comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve or disapprove the proposed rule change, or
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BX-2010-079 on the subject line.

### *Paper Comments*

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-BX-2010-079. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of the filing will also be available for inspection and copying at the Exchange's principal office. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-BX-2010-079 and should be submitted on or before January 10, 2011.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>15</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> 17 CFR 200.30-3(a)(12).