

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 such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

#### 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 email to [rule-comment@sec.gov](mailto:rule-comment@sec.gov). Please include File No. SR-FICC-2014-06 on the subject line.

##### *Paper Comments*

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

All submissions should refer to File Number SR-FICC-2014-06. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C 552, will be available for 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 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on its Web site at <http://www.dtcc.com/~media/Files/Downloads/legal/rule-filings/2014/ficc/SR-FICC-2014-06.pdf>. All comments

received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2014-06 and should be submitted on or before January 2, 2015.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>5</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

[FR Doc. 2014-29179 Filed 12-11-14; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-73784; File No. SR-BX-2014-049]

### Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing of Proposed Rule Change Relating to Directed Market Makers

December 8, 2014.

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 November 25, 2014, NASDAQ OMX BX, Inc. ("BX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to add definitions of Directed Order and Directed Market Maker ("DMM"), as well as provisions concerning the designation of an order as a Directed Order and DMM market making obligations. The proposal also revises priority rules to provide for a DMM participation entitlement. Finally, the rule makes certain clarifications to the text of rules governing Lead Market Makers ("LMMs"). The proposal seeks to enable BX to compete with the many options exchanges that offer directed orders in their respective markets.

The text of the proposed rule change is available on the Exchange's Web site at <http://>

<sup>5</sup> 17 CFR 200.30-3(a)(12).

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

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

[nasdaqomxbx.cchwallstreet.com](http://nasdaqomxbx.cchwallstreet.com), at the principal office of 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 Exchange 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 Exchange 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 the Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The purpose of the proposed rule change is to adopt rules to permit BX Market Makers to act as Designated Market Makers, or DMMs, in their appointed options classes, provided the DMM meets certain obligations and quoting requirements as provided for in the new proposed Exchange Rules. The Exchange proposes to provide DMMs with certain participation entitlements. The Exchange believes that these amendments, described below in greater detail, will enhance competition by affording the BX Options market the opportunity to compete for directed order flow.

###### Current Categories of BX Options Participants

Today on BX there are three types of Options Participants: Options Order Entry Firms, Options market makers and LMMs. Options Order Entry Firms, or OEFs, are Options Participants who represent customer orders as agent on BX Options and non-market maker Participants conducting proprietary trading as principal.

Options market makers are Options Participants registered with the Exchange as options market makers in one or more listed options on BX.<sup>3</sup> BX Options market makers are required to electronically engage in a course of dealing to enhance liquidity available on BX and to assist in the maintenance of fair and orderly markets.<sup>4</sup> Among

<sup>3</sup> See BX Options Rules at Chapter VII.

<sup>4</sup> Options market makers receive certain benefits for carrying out their duties. For example, a lender may extend credit to a broker-dealer without regard

other things, Options market makers must quote 60 percent of the trading day (as a percentage of the total number of minutes in such trading day) or such higher percentage as BX may announce in advance.<sup>5</sup>

Recently, the Exchange adopted rules providing that an approved BX Options market maker may become an LMM in one or more listed options, provided that each class is limited to one LMM.<sup>6</sup> BX does not limit the number of entities that may become LMMs. LMMs are subject to more extensive obligations than other BX Options market makers, including an obligation to provide continuous two-sided quotations meeting certain quote width requirements throughout the trading day in its appointed issues for 90 percent of the time the Exchange is open for trading in each issue.<sup>7</sup> The Exchange provides LMMs with specific participation entitlements in Chapter VI (Trading Systems) at Section 10, entitled "Book Processing."

#### DMM Designation and Directed Orders

The Exchange is now proposing to define Directed Orders and to provide for another category of market maker, the DMM. A "Directed Order" would be defined as an order to buy or sell which has been directed (pursuant to the Exchange's instructions on how to direct an order) to a particular market maker (the DMM with respect to that

to the restrictions in Regulation T of the Board of Governors of the Federal Reserve System if the credit is to be used to finance the broker-dealer's activities as market maker on a national securities exchange. Thus, an Options market maker has a corresponding obligation to hold itself out as willing to buy and sell options for its own account on a regular or continuous basis to justify this favorable treatment.

<sup>5</sup> BX Regulation may consider exceptions to the requirement to quote 60 percent (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. Market makers are not required to make two-sided markets pursuant to Section 5(a)(i) of Chapter VII in any Quarterly Option Series, adjusted option series, or any option series until the time to expiration for such series is less than nine months. Accordingly, the continuous quotation obligations set forth in this rule do not apply to market makers respecting Quarterly Option Series, adjusted option series, or any series with an expiration of nine months or greater. If a technical failure or limitation of a system of BX prevents a market maker from maintaining, or prevents a market maker from communicating to BX Options, timely and accurate quotes, the duration of such failure or limitation shall not be included in any of these calculations with respect to the affected quotes. Substantial or continued failure by an Options market maker to meet any of its obligations and duties, will subject the Options market maker to disciplinary action, suspension, or revocation of the Options market maker's registration in one or more options series. See obligations of Options market makers in Chapter VII, Section 6.

<sup>6</sup> See Chapter VII, Section 13.

<sup>7</sup> See Chapter VII, Section 14.

Directed Order).<sup>8</sup> Pursuant to a proposed amendment to Chapter VI, Section 6(a)(2), Limit Orders,<sup>9</sup> Minimum Quantity Orders,<sup>10</sup> Market Orders,<sup>11</sup> Price Improving Orders,<sup>12</sup> All-or-None Orders<sup>13</sup> and Post-Only Orders<sup>14</sup> may all be designated as

<sup>8</sup> See proposed Chapter VI, Section 1(e)(1), which replaces a Reserved section with a definition of Directed Order. The new provision also states that Directed Orders are handled within the System pursuant to Chapter VI, Section 10.

<sup>9</sup> See Chapter VI, Section 1(e)(2). "Limit Orders" are orders to buy or sell an option at a specified price or better. A limit order is marketable when, for a limit order to buy, at the time it is entered into the System, the order is priced at the current inside offer or higher, or for a limit order to sell, at the time it is entered into the System, the order is priced at the inside bid or lower.

<sup>10</sup> See Chapter VI, Section 1(e)(3). "Minimum Quantity Orders" are orders that require that a specified minimum quantity of contracts be obtained, or the order is cancelled. Minimum Quantity Orders are treated as having a time-in-force designation of Immediate or Cancel. Minimum Quantity Orders received prior to the opening cross or after market close will be rejected.

<sup>11</sup> See Chapter VI, Section 1(e)(5). "Market Orders" are orders to buy or sell at the best price available at the time of execution. Participants can designate that their Market Orders not executed after a pre-established period of time, as established by the Exchange, will be cancelled back to the Participant.

<sup>12</sup> See Chapter VI, Section 1(a)(6). "Price Improving Orders" are orders to buy or sell an option at a specified price at an increment smaller than the minimum price variation in the security. Price Improving Orders may be entered in increments as small as one cent. Price Improving Orders that are available for display shall be displayed at the minimum price variation in that security and shall be rounded up for sell orders and rounded down for buy orders.

<sup>13</sup> See Chapter VI, Section 1(e)(10). "All-or-none" shall mean a market or limit order which is to be executed in its entirety or not at all. All-or-None Orders are treated as having a time-in-force designation of Immediate or Cancel. All-or-None Orders received prior to the opening cross or after market close will be rejected.

<sup>14</sup> See Chapter VI, Section 1(e)(11). "Post-Only Orders" are orders that will not remove liquidity from the System. Post-Only Orders are to be ranked and executed on the Exchange or cancelled, as appropriate, without routing away to another market. Post-Only Orders are evaluated at the time of entry with respect to locking or crossing other orders as follows: (i) If a Post-Only Order would lock or cross an order on the System, the order will be re-priced to \$.01 below the current low offer (for bids) or above the current best bid (for offers) and displayed by the System at one minimum price increment below the current low offer (for bids) or above the current best bid (for offers); and (ii) if a Post-Only Order would not lock or cross an order on the System but would lock or cross the NBBO as reflected in the protected quotation of another market center, the order will be handled pursuant to Chapter VI, Section 7(b)(3)(C). Participants may choose to have their Post-Only Orders returned whenever the order would lock or cross the NBBO or be placed on the book at a price other than its limit price. Post-Only Orders received prior to the opening cross or after market close will be rejected. Post-Only Orders may not have a time-in-force designation of Good Til Cancelled or Immediate or Cancel. Although a Post-Only Order may be designated as a Directed Order, because it is not executed immediately upon receipt it will never result in the awarding of a DMM participation entitlement as discussed below.

Directed Orders. A Directed Order may also be designated as Immediate or Cancel ("IOC"),<sup>15</sup> Good-till-Cancelled ("GTC"),<sup>16</sup> Day ("DAY")<sup>17</sup> or a WAIT<sup>18</sup> order pursuant to Chapter VI, Section 6(a)(1) as proposed to be amended. New Section 15, DMMs, of Chapter VII, Market Participants, provides that market makers may receive Directed Orders in their appointed classes as provided therein, provided they indicated to the Exchange, in a form specified, that they will receive Directed Orders. Directed Orders may be available only in certain options.<sup>19</sup>

Pursuant to new Chapter VII, Market Participants, Section 15, when the Exchange's disseminated price is the NBBO at the time of receipt of the Directed Order, and the DMM is quoting at or improving<sup>20</sup> the Exchange's

<sup>15</sup> See Chapter VI, Section 1(g)(2). "Immediate Or Cancel" or "IOC" shall mean for orders so designated, that if after entry into the System a marketable order (or unexecuted portion thereof) becomes non-marketable, the order (or unexecuted portion thereof) shall be canceled and returned to the entering participant. IOC Orders shall be available for entry from the time prior to market open specified by the Exchange on its Web site until market close and for potential execution from 9:30 a.m. until market close. IOC Orders entered between the time specified by the Exchange on its Web site and 9:30 a.m. Eastern Time will be held within the System until 9:30 a.m. at which time the System shall determine whether such orders are marketable. IOC orders can be routed if designated as routable.

<sup>16</sup> See Chapter VI, Section 1(g)(4). "Good Til Cancelled" or "GTC" shall mean for orders so designated, that if after entry into System, the order is not fully executed, the order (or unexecuted portion thereof) shall remain available for potential display and/or execution unless cancelled by the entering party, or until the option expires, whichever comes first. GTC Orders shall be available for entry from the time prior to market open specified by the Exchange on its Web site until market close and for potential execution from 9:30 a.m. until market close.

<sup>17</sup> See Chapter VI, Section 1(g)(3). "DAY" shall mean for orders so designated, that if after entry into the System, the order is not fully executed, the order (or unexecuted portion thereof) shall remain available for potential display and/or execution until market close, unless canceled by the entering party, after which it shall be returned to the entering party. DAY Orders shall be available for entry from the time prior to market open specified by the Exchange on its Web site until market close and for potential execution from 9:30 a.m. until market close.

<sup>18</sup> See Chapter VI, Section 1(g)(5). "WAIT" shall mean for orders so designated, that upon entry into the System, the order is held for one second without processing for potential display and/or execution. After one second, the order is processed for potential display and/or execution in accordance with all order entry instructions as determined by the entering party.

<sup>19</sup> The Exchange would specify via an Options Trader Alert which options would be subject to the Directed Orders provisions specified herein.

<sup>20</sup> Today, BX Options Participants enter Price Improving Orders, which orders have a specified price smaller than the minimum price variation ("MPV") in the option. Price Improving Orders may

disseminated price, the Directed Order will be automatically executed and allocated in accordance with Chapter VI, Section 10 such that the DMM will receive a DMM participation entitlement provided for in Chapter VI, Section 10, discussed below.<sup>21</sup> If the DMM participation entitlement is not awarded at the time of receipt of the Directed Order, no DMM participation entitlement will apply and the order will be handled as though it were not a Directed Order for the remainder of the life of the order. However, when (a) the Exchange's disseminated price is the NBBO, and the quotation disseminated by the DMM on the opposite side of the market from the Directed Order is inferior to the NBBO at the time of receipt of the Directed Order, or (b) the Exchange's disseminated price is not the NBBO at the time of receipt of the Directed Order, the Directed Order will be processed as though it were not a Directed Order.<sup>22</sup>

New Section 15 requires a DMM to provide continuous two-sided quotations throughout the trading day in all options issues in which the DMM is assigned for 90 percent of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements of Chapter VII, Section 6. These obligations will apply collectively to all series in all of the issues, rather than on an issue-by-issue basis once the market maker has indicated to the Exchange that the market maker will be receiving Directed Orders. While the Market Maker's quoting requirement is a daily obligation, the Exchange is able to determine compliance with these obligations on a monthly basis. BX Regulation may consider exceptions to the requirement to quote 90% (or higher) of the trading day based on

be entered in increments as small as one cent. Price Improving Orders will be displayed at the MPV in that security and rounded up for sell orders and down for buy orders. Without this order type, market participants would not be able to submit orders priced between the MPV. Instead, orders, if submitted, would be priced (and displayed) at the MPV. The treatment of Price Improving Orders is not altered by this rule change. It is consistent to account for the possibility that the DMM improves the Exchange's disseminated price by submitting a marketable order in a non-standard increment, which in this case, would aggressively improve the NBBO. Awarding a participation entitlement to a DMM will not otherwise change the manner in which Price Improving Orders will be displayed at the MPV and available to be executed at price improving increments.

<sup>21</sup> Chapter VII, Market Participants, Section 15, Directed Market Makers, subsection (i) Price Improving Orders from a DMM participant which are reflected on OPRA at the NBBO retain price priority and are eligible for a DMM participation entitlement.

<sup>22</sup> See Chapter VII, Market Participants, Section 15, Directed Market Makers, subsection (ii).

demonstrated legal or regulatory requirements or other mitigating circumstances.<sup>23</sup> If a technical failure or limitation of a system of the Exchange prevents a DMM from maintaining, or prevents a DMM from communicating to the Exchange, timely and accurate electronic quotes in an issue, the duration of such failure shall not be considered in determining whether the DMM has satisfied the 90 percent quoting standard with respect to that option issue. Further, these obligations shall not apply to DMMs with respect to Quarterly Options Series, adjusted option series,<sup>24</sup> or any series with a time to expiration of nine months or greater. However, a DMM may still receive a participation entitlement in such series if it elects to quote in such series and otherwise satisfies the requirements of Chapter VI, Section 10.

#### LMM and New DMM Participation Entitlements

By way of background, Chapter VI, Trading System, Section 10, Book Processing, currently provides that the Exchange will determine to apply, for each option, either a Price/Time or a Size Pro-Rata execution algorithm. In addition to describing each execution algorithm, Chapter VI, Section 10 also describes certain priority overlays applicable to each of those algorithms.

Currently, under both Price/Time and Size Pro-Rata algorithms, Public Customer Priority is always in effect and provides that the highest bid and lowest offer have priority except that Public Customer orders have priority over non-Public Customer orders at the same price. If there are two or more Public Customer orders for the same options series at the same price, priority is afforded to such Public Customers orders in the sequence in which they are received by the System. For purposes of the Public Customer Priority overlay, a Public Customer order does not include a Professional<sup>25</sup> order.

Chapter VI, Section 10 also currently provides for a LMM priority overlay after all Public Customer orders have been fully executed, upon receipt of an

<sup>23</sup> Chapter VII, Market Participants, Section 15, Directed Market Makers, subsection (iii).

<sup>24</sup> An adjusted option series is an option series wherein, as a result of a corporate action by the issuer of the underlying security, one option contract in the s [sic]

<sup>25</sup> See Chapter I, Section 1(a)(49). The term "Professional" means any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). A Participant or a Public Customer may, without limitation, be a Professional. All Professional orders shall be appropriately marked by Participants.

order, provided the LMM's bid/offer is at the Exchange's disseminated price. The LMM priority overlay applies under both the Price/Time and the Size Pro-Rata execution algorithms, if applicable.

Specifically, with respect to Size Pro-Rata executions, the Exchange affords an LMM a participation entitlement if the LMM's bid/offer is at or better than the Exchange's disseminated price and all Public Customer<sup>26</sup> orders have been fully executed.<sup>27</sup> The LMM is not entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. LMM participation entitlements are considered after the opening process. The LMM participation entitlement provides a BX Options LMM with the greater of: The LMM's Size Pro-Rata share; 50 percent of remaining interest if there is one or no other market maker at that price; 40 percent of remaining interest if there are two other market makers at that price; or 30 percent of remaining interest if there are more than two other market makers at that price; or if rounding would result in an allocation of less than one contract, a BX Options LMM receives one contract. Rounding is up or down to the nearest integer.<sup>28</sup> After all Public Customer orders have been fully executed and LMM participation entitlements applied, if applicable, BX Options market makers then have priority over all other Participant orders at the same price.<sup>29</sup>

For symbols trading under the Price/Time algorithm, the Public Customer Priority Overlay is always in effect. Chapter VI, Section 10 also currently provides for a LMM priority overlay after all Public Customer orders have been fully executed, upon receipt of an order, provided the LMM's bid/offer is at or better than the Exchange's disseminated price, the LMM is afforded a participation entitlement.<sup>30</sup> The LMM is not entitled to receive a number of contracts that is greater than the displayed size associated with such LMM. After Public Customers orders have been executed, a BX Options LMM

<sup>26</sup> See Chapter I, Section 1(50). The term "Public Customer" means a person that is not a broker or dealer in securities.

<sup>27</sup> Price Improving Orders retain price priority before an LMM participation entitlement is provided at the Exchange's disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

<sup>28</sup> When the decimal is exactly 0.5, the rounding direction is up to the nearest integer.

<sup>29</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsection (C)(2)(ii)(1).

<sup>30</sup> As is the case with Size Pro-Rata executions discussed above, Price Improving Orders retain price priority before an LMM participation entitlement is provided at the Exchange's disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

receives the greater of: (a) Contracts the LMM would receive if the allocation was based on time priority with Public Customer priority; (b) 50 percent of remaining interest if there is one or no other market maker at that price; (c) 40 percent of remaining interest if there are two other market makers at that price; or (d) 30 percent of remaining interest if there are more than two other market makers at that price or if rounding would result in an allocation of less than one contract, a BX Options LMM receives one contract. Rounding is up or down to the nearest integer.<sup>31</sup>

Under both the Price/Time algorithm and the Size Pro-Rata algorithm, Orders for 5 contracts or fewer are allocated to the LMM. The Exchange reviews this provision quarterly and maintains the small order size at a level that will not allow orders of 5 contracts or less executed by the LMM to account for more than 40 percent of the volume executed on the Exchange.<sup>32</sup>

The Exchange is now proposing to amend its rules to provide for a DMM priority entitlement under both the Price/Time and the Size Pro-Rata algorithm, and to make certain corresponding changes and clarifications to the current LMM participation entitlements. Under both Price/Time and Size Pro-Rata algorithms, a market maker which receives a Directed Order is a DMM with respect to that Directed Order. After all Public Customer orders at a given price point have been fully executed, upon receipt of a Directed Order, provided the DMM's bid/offer is at or improves the NBBO, the DMM will be afforded a participation entitlement<sup>33</sup> at the last execution price, which is equal to or better than the NBBO if the DMM executed the order at such price. The DMM shall not be entitled to receive a number of contracts that is greater than the displayed size at a given price point associated with such DMM. DMM participation entitlements will be considered after the opening process. Chapter VI, Section 10(C)(1)(c) specifies that under the Price/Time execution algorithm, DMM participant entitlements (like LMM participation entitlements)<sup>34</sup> shall only be in effect

when the Public Customer Priority Overlay is also in effect.

Pursuant to the DMM participation entitlement in effect under the Price/Time algorithm, the DMM would receive, with respect to a Directed Order, the greater of: (1) Contracts the DMM would receive if the allocation was based on time priority pursuant to subparagraph (C)(1)(a) with Public Customer priority; (2) after Public Customer orders are executed, 40 percent of remaining interest; or (3) the LMM participation entitlement (if the DMM is also the LMM). If there are multiple DMM quotes at the same price which are at or improve the NBBO when the Directed Order is received, the DMM participation entitlement would apply only once to the one which has the highest time priority at the last price executed upon receipt of the Directed Order which is equal to or better than the NBBO. If rounding would result in an allocation of less than one contract, the DMM would receive one contract. Rounding would be up or down to the nearest integer.<sup>35</sup> Under no circumstances would the DMM receive an allocation of greater than 40% of an order at a price at which they receive a directed entitlement, unless it resulted from rounding.

Pursuant to the DMM participation entitlement in effect under the Size Pro-Rata algorithm, the DMM would receive, with respect to a Directed Order, the greater of: (1) The DMM's Size Pro-Rata share under subsection (1)(C)(2)(iv); (2) after Public Customer orders are executed, 40 percent of remaining interest; or (3) the LMM participation entitlement (if the DMM is also the LMM). If there are multiple DMM quotes at the same price which are at or improve the NBBO when the Directed Order is received, the DMM participation entitlement would apply only to the one which has the highest time priority at the last price executed upon receipt of the Directed Order which is equal to or better than the NBBO. Additional DMM quotes at such price will receive no further allocation of the Directed Order. Like the DMM participation entitlement applicable to executions under the Price/Time algorithm, if rounding would result in an allocation of less than one contract, the DMM would receive one contract, and rounding would be up or down to the nearest integer.<sup>36</sup> Under no circumstances would the DMM receive an allocation of greater than 40% of an

order at a price at which they receive a directed entitlement, unless it resulted from rounding.

As noted above, under both execution algorithms only one participation entitlement, LMM or DMM, may be applied on a given order. The Exchange is amending the current LMM entitlements under each algorithm to provide with respect to a Directed Order that if the LMM is also the DMM, the LMM shall receive the DMM participation entitlement applicable to that algorithm, if any, if such DMM participation entitlement is greater than the LMM participation entitlement the LMM would otherwise receive pursuant to Chapter VI, Section 10, subsections (C)(1)(b)(1)(a)–(d) (in the case of Price/Time symbols) or (C)(2)(ii)(1)(a)–(d) (in the case of Size Pro-Rata symbols). The Exchange is also modifying the LMM priority rules so that the LMM participation entitlement will not apply to a Directed Order if when it is received the DMM's bid/offer is at or improves<sup>37</sup> the NBBO and the LMM is at the same price level and the LMM is not the DMM.<sup>38</sup>

The Exchange is also proposing to revise the current allocation to the LMM of orders for five contracts or fewer (which applies under both algorithms). As revised, the provision would not apply if the order of 5 contracts or fewer is directed to a DMM who is quoting at the NBBO.<sup>39</sup>

Currently, with respect to executions under the Size Pro-Rata algorithm, BX Options market makers have priority over all other Participant orders at the same price after all Public Customer orders have been fully executed and LMM participation entitlements applied. The Exchange proposes to amend this provision so that this BX Options market maker priority applies only after any DMM participation entitlements have been applied as well.<sup>40</sup>

Finally, the Exchange proposes to clarify with respect to LMMs under both execution algorithms that after all Public Customer orders have been fully executed, upon receipt of an order, the LMM will be afforded a participation entitlement provided that LMM's bid/offer is at or improves upon the

<sup>31</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsection (C)(1)(b)(1).

<sup>32</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsections (C)(1)(b)(2) and (C)(2)(ii)(2).

<sup>33</sup> As with the LMM participation entitlements discussed above, Price Improving Orders retain price priority. A DMM participation entitlement will only be provided at the last price executed which is equal to or better than the Exchange's disseminated price. See Chapter VI, Sections 1(a)(6) and 7(b)(3)(B).

<sup>34</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsection (C)(1)(b).

<sup>35</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsections (C)(1)(c).

<sup>36</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsection (C)(2)(iii).

<sup>37</sup> See note 20.

<sup>38</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsections (C)(1)(b)(1) (with respect to Price/Time symbols) and (C)(2)(ii)(1) (with respect to Size Pro-Rata Symbols).

<sup>39</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsections (C)(1)(b)(2) (with respect to Price/Time symbols) and (C)(2)(ii)(2) (with respect to Size Pro-Rata Symbols).

<sup>40</sup> Chapter VI, Trading Systems, Section 10, Book Processing, subsection (C)(2)(iv).

Exchange's disseminated price. The addition of the reference to an improved bid/offer will conform the LMM provision to the corresponding new DMM provision.<sup>41</sup> The Exchange is also making a clarifying change in Chapter VI, Section 10(1)(C)(1)(b)(1)(a) by changing "subparagraph (1)(a) above" to "subparagraph (C)(1)(a) above."

#### Examples of DMM Participation Entitlement Under Price/Time Algorithm

Examples 1 through 3 below illustrate the manner in which a DMM will be allocated pursuant to the Price/Time model.

##### Example Number 1

Assume an LMM has been assigned and that the DMM is not the LMM.

ABBO = 1.00–1.10

BX BBO = 1.00–1.10 comprised of the following in order of receipt

Market Maker 1 ("MM1") 1.00 (10)–1.10 (10)

Customer A 5 offered at 1.10

Firm 5 offered at 1.10

DMM 1.00 (10)–1.10 (20)

LMM 1.00 (10)–1.10 (10)

Customer B 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Price/Time with Customer Priority would result in Customer A trading 5, Customer B trading 2, MM1 trading 10, Firm trading 5, and DMM trading 18.

The DMM allocation would result in Customer A trading 5, Customer B trading 2, and DMM trading 40% of remaining  $33 = 13$  (13.2 rounded down); then normal price/time would resume and MM1 would trade 10, Firm would trade 5, and LMM would trade 5.

The LMM allocation is not calculated.

In this example, Price/Time with Customer Priority would prevail since the DMM would receive a greater allocation this way.

##### Example Number 2

Assume an LMM is assigned and that the DMM is not the LMM.

ABBO = 1.00–1.10

BX BBO = 1.00–1.10 comprised of the following in order of receipt

MM1 1.00 (10)–1.10 (10)

Customer A 5 offered at 1.10

Firm 5 offered at 1.10

Market Maker 2 ("MM2") 1.00 (10)–1.10 (10)

DMM 1.00 (10)–1.10 (20)

Customer B 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Price/Time with Customer Priority would result in Customer A trading 5, Customer B trading 2, MM1 trading 10, Firm trading 5, MM2 trading 10 and DMM trading 8.

The DMM allocation would result in Customer A trading 5, Customer B trading 2, DMM trading 40% of remaining  $33 = 13$  (13.2 rounded down); then normal price/time would resume with MM1 trading 10, Firm trading 5 and MM2 trading 5.

The LMM allocation would not be calculated.

In this example, the DMM allocation would prevail since the DMM receives a greater allocation this way.

##### Example Number 3

Assume an LMM is assigned and that the DMM is also the LMM.

ABBO = 1.00–1.10

BX BBO = 1.00–1.10 comprised of the following in order of receipt:

MM1 1.00 (10)–1.10 (10)

Firm 25 offered at 1.10

DMM/LMM 1.00 (10)–1.10 (20)

Customer B 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Price/Time with Customer Priority would result in Customer B trading 2, MM1 trading 10, Firm trading 25, and DMM/LMM trading 3.

DMM allocation would result in Customer B trading 2 and DMM/LMM trading 40% of remaining  $38 = 15$  (15.2 rounded down); then normal price/time would resume and MM1 would trade 10 and Firm would trade 13.

LMM allocation would result in Customer B trading 2 and DMM/LMM trading 50% of remaining  $38 = 19$ ; then normal price time would resume and MM1 would trade 10 and Firm would trade 9.

In this example, the LMM allocation would prevail since the DMM/LMM would receive a greater allocation this way.

#### Examples of DMM Participation Entitlement Under Size Pro-Rata Algorithm

Examples 4 through 6 below illustrate the manner in which a DMM will be allocated pursuant to the Size Pro-Rata model.

##### Example Number 4

Assume an LMM is assigned and the DMM is not the LMM.

ABBO = 1.00–1.10

BX BBO = 1.00–1.10 comprised of the following in order of receipt:

LMM 1.00 (10)–1.10 (15)

Customer A 5 offered at 1.10

Firm 5 offered at 1.10

DMM 1.00 (10)–1.10 (20)

MM1 1.00 (10)–1.10 (10)

Customer B 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, LMM trading 11 (15/45\*33remaining), DMM trading 14 (20/45\*33), MM1 trading 7 (10/45\*33), and then LMM based on time receiving the residual 1 lot.

The DMM allocation would result in Customer A trading 5, Customer B trading 2, and DMM trading 40% of remaining  $33 = 13$  (13.2 rounded down); then normal Size Pro-Rata for remaining with the LMM trading 12 (15/25\*20) and MM1 trading 8 (10/25\*20).

The LMM allocation would not be calculated.

In this example, the Size Pro-Rata allocation would prevail since the DMM would receive the greater allocation this way.

##### Example Number 5

Assume that no LMM is assigned.

ABBO = 1.00–1.10

BX BBO = 1.00–1.10 comprised of the following in order of receipt:

DMM 1.00 (10)–1.10 (15)

Customer A 5 offered at 1.10

Firm 5 offered at 1.10

MM1 1.00 (10)–1.10 (20)

MM2 1.00 (10)–1.10 (10)

Customer B 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:

Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, DMM trading 11 (15/45\*33remaining), MM1 trading 14 (20/45\*33), MM2 trading 7 (10/45\*33), and the DMM based on time receiving the residual 1 lot.

The DMM allocation would result in Customer A trading 5, Customer B trading 2, and DMM trading 40% of remaining  $33 = 13$  (13.2 rounded down); then normal Size Pro-Rata for remaining with MM1 trading 13 (20/30\*20) and MM2 trading 6 (10/30\*20), and the DMM based on time receiving the residual 1 lot.

The LMM allocation would not be calculated.

In this example, the DMM allocation would prevail since the DMM would receive the greater allocation this way.

##### Example Number 6

Assume that an LMM is assigned and that the DMM is also the LMM.

<sup>41</sup> See note 20.

ABBO = 1.00–1.10  
 BX BBO = 1.00–1.10 comprised of the following in order of receipt:

DMM/LMM 1.00 (10)–1.10 (15)  
 Customer A 5 offered at 1.10  
 Firm 5 offered at 1.10  
 MM1 1.00 (10)–1.10 (30)  
 Customer B 2 offered at 1.10

Incoming Directed Order to pay 1.10 for 40 contracts.

Determination of Allocation:  
 Size Pro-Rata would result in Customer A trading 5, Customer B trading 2, DMM/LMM trading 11 (15/45\*33 remaining), MM1 trading 22 (30/45\*33).

The DMM allocation would result in Customer A trading 5, Customer B trading 2, and DMM/LMM trading 40% of remaining 33 = 13 (13.2 rounded down); then Size Pro-Rata for remaining with MM1 trading full size of 20.

The LMM allocation would result in Customer A trading 5, Customer B trading 2, and DMM/LMM entitled to 50% of remaining 33 = 17 (16.5 rounded up) but capped at his size of 15 thus trading 15; then normal Size Pro-Rata for remaining with MM1 trading 18.

In this example, the LMM allocation would prevail since the DMM is the LMM and would receive a greater allocation this way.

#### Examples of Price Improving Orders

##### *Example Number 1*

For this scenario assume the NBBO is at 1.00 (bid) and 1.20 (offer).

Assume a Price Improving Order (O1) from a Customer is present on BX to sell 20 contracts at 1.18. Also assume a Directed Market Maker (DMM1) and two other Market Makers (MM2 and MM3) are each quoting 1.00–1.20 with a size of 50 contracts on each side. O1 and the Market Maker quotes are reflected in the BX BBO as 1.00–1.20 with a size of 150 contracts on the bid and 170 contracts on the offer. If an order (O2) is received to buy 50 contracts at a limit of 1.20 which is directed to DMM1, the order will execute upon receipt with 20 contracts trading against O1 at 1.18, 12 contracts trading against DMM1 at 1.20 (40% of remaining 30 contracts), 9 contracts trading against MM2 at 1.20, and 9 contracts trading against MM3 at 1.20.

##### *Example Number 2*

For this scenario assume the NBBO is at 1.00 (bid) and 1.20 (offer).

Assume two Price Improving Orders (O1 and O2) from a Customer (C1) and Directed Market Maker (DMM1), respectively, are present on BX to sell 10 contracts each at 1.18. Also assume the Directed Market Maker (DMM1) and

two other Market Makers (MM2 and MM3) are each quoting 1.00–1.20 with a size of 50 contracts on each side. O1, O2, and the Market Maker quotes are reflected in the BX BBO as 1.00–1.20 with a size of 150 contracts on the bid and 170 contracts on the offer. If an order (O3) is received to buy 50 contracts at a limit of 1.20 which is directed to DMM1, the order will execute upon receipt with 10 contracts trading against O1 at 1.18 and 10 contracts trading against DMM1's Price Improving Order (O2) at 1.18. The remaining 30 contracts will trade at 1.20 with 12 contracts trading against DMM1 (40% of remaining 30 contracts), 9 contracts trading against MM2, and 9 contracts trading against MM3.

##### *Example Number 3*

Assume the following orders exist in the Order book for Market Maker 2 and 3 (MM2 and MM3 respectively) and the following DMM quotes:

1.19 offer 10 MM2 (Price Improving Order)  
 1.20 offer 20 MM3  
 1.20 offer 10 DMM Quote 1  
 1.20 offer 10 DMM Quote 2

If an order was directed to the DMM to buy 15 contracts at 1.20, 10 contracts would be executed at 1.19 contra MM2. The DMM would receive 40% of the remaining 5 contracts (2 contracts) which would be allocated to DMM Quote 1. The remaining 3 contracts would be allocated as per Price Time priority to MM3.

##### *Example Number 4*

Assume the following orders exist in the Order book for Market Maker 2 and 3 (MM2 and MM3 respectively) and the following DMM quotes:

1.18 offer 10 MM2 (Price Improving Order)  
 1.19 offer 20 MM3  
 1.19 offer 10 DMM Quote 1  
 1.19 offer 10 DMM Quote 2  
 1.20 offer 10 MM3

If an order directed to the DMM to buy 15 contracts for 1.20, 10 contracts would be executed at 1.18 contra MM2. The DMM would receive 40% of remaining 5 contracts (2 contracts), because it was the last price executed pursuant to Chapter VI, Section 10(1)(C)(1)(c), which would be allocated to DMM Quote 1. The remaining 3 contracts would be allocated as per Price Time priority to MM3.

#### Priority Overlays

The Exchange is proposing to amend language in Chapter VI, Section 10(1)(C)(2) which applies to priority overlays. The language currently states

that “the Exchange will apply the following designated Participant priority overlays, which are always in effect when the Size Pro-Rata execution algorithm is in effect.” The priority overlays which are references are Public Customer, LMM, DMM and market maker priority. The Exchange is proposing to amend the sentence to state, “the Exchange *may* apply the following designated Participant priority overlays, when the Size Pro-Rata execution algorithm is in effect.” The amendment is intended to provide more specificity to the rule text as Public Customer priority will be in effect always for Size Pro-Rata, but may be in effect for the other types of priorities. The amendment also conforms the language to the Price/Time rule text in Chapter VI, Section 10(1)(C)(1).

#### Implementation.

Within thirty (30) days the Exchange will begin to implement the proposal and will issue an Options Trader Alert in advance to inform market participants of such date.

#### 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act<sup>42</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act<sup>43</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest, because it will establish a Directed Order process similar to what operates on other exchanges, as explained herein, which will provide Participants with additional choices among the many competing exchanges with regard to their execution needs and strategies. BX Options operates in an intensely competitive environment and seeks to offer the same services that its competitors offer and in which its customers find value.

In its approval of other options exchange directed order programs, the Commission has, like proposals to amend a specialist guarantee, focused on whether the percentage of the “entitlement” would rise to a level that could have a material adverse impact on quote competition within a particular

<sup>42</sup> 15 U.S.C. 78f(b).

<sup>43</sup> 15 U.S.C. 78f(b)(5).

exchange, and concluded that such programs do not jeopardize market integrity or the incentive for market participants to post competitive quotes.<sup>44</sup> BX's proposed DMM participation entitlement of 40 percent, is consistent with the directed order allocations of other options exchanges. BX notes that the remaining portion of each order will continue to be allocated based on the competitive bids/offers of market participants. In addition, at the time of receipt of the Directed Order, a DMM will have to be quoting at or improving<sup>45</sup> the NBBO which is intended to incent the DMM to quote aggressively. BX also notes that DMMs will have heightened quoting obligations as compared to other BX Options market makers.

A DMM will have to be quoting at or improving the NBBO at the time the order is received to capitalize on the guarantee and will only receive a participation entitlement at one such price point. The DMM must be publicly quoting at that price when the order is received. In this regard, the proposal prohibits an order flow provider from notifying a DMM regarding its intention to submit a Directed Order so that such DMM could change its quotation immediately prior to submission of the directed order. The Exchange's rules already provide the necessary protections against coordinated action as between a DMM and an order entry firm.<sup>46</sup> Furthermore, BX will proactively conduct surveillance for, and enforce against, such violations.<sup>47</sup>

In addition, this proposal does not affect a broker-dealer's duty of best execution. A broker-dealer has a legal duty to seek to obtain best execution of customer orders, and any decision to preference a particular DMM must be consistent with this duty.<sup>48</sup> A broker-

dealer's duty of best execution derives from common law agency principles and fiduciary obligations, and is incorporated in SRO rules and, through judicial and Commission decisions, the antifraud provisions of the federal securities laws.<sup>49</sup> The duty of best execution requires broker-dealers to execute customer trades at the most favorable terms reasonably available under the circumstances, *i.e.*, at the best reasonably available price.<sup>50</sup> The duty of best execution requires broker-dealers to periodically assess the quality of competing markets to assure that order flow is directed to the markets providing the most beneficial terms for their customer orders.<sup>51</sup> Broker-dealers

(*2d Cir.* 1971); *Arleen Hughes*, 27 SEC 629, 636 (1948), *aff'd sub nom. Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949)). See also Order Execution Obligations, Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996) ("Order Handling Rules Release").

<sup>49</sup> Order Handling Rules Release, 61 FR at 48322. See also *Newton*, 135 F.3d at 270. Failure to satisfy the duty of best execution can constitute fraud because a broker-dealer, in agreeing to execute a customer's order, makes an implied representation that it will execute it in a manner that maximizes the customer's economic gain in the transaction. See *Newton*, 135 F.3d at 273 ("[T]he basis for the duty of best execution is the mutual understanding that the client is engaging in the trade—and retaining the services of the broker as his agent—solely for the purpose of maximizing his own economic benefit, and that the broker receives her compensation because she assists the client in reaching that goal."); *Marc N. Geman*, Securities Exchange Act Release No. 43963 (February 14, 2001) (citing *Newton*, but concluding that respondent fulfilled his duty of best execution). See also Payment for Order Flow, Securities Exchange Act Release No. 34902 (October 27, 1994), 59 FR 55006, 55009 (Nov. 2, 1994) ("Payment for Order Flow Final Rules"). If the broker-dealer intends not to act in a manner that maximizes the customer's benefit when he accepts the order and does not disclose this to the customer, the broker-dealer's implied representation is false. See *Newton*, 135 F.3d at 273–274.

<sup>50</sup> *Newton*, 135 F.3d at 270. *Newton* also noted certain factors relevant to best execution—order size, trading characteristics of the security, speed of execution, learning costs, and the cost and difficulty of executing an order in a particular market. *Id.* at 270 n. 2 (citing Payment for Order Flow, Securities Exchange Act Release No. 33026 (October 6, 1993), 58 FR 52934, 52937–38 (October 13, 1993) (Proposed Rules)). See *In re E.F. Hutton & Co.* ("Manning"), Securities Exchange Act Release No. 25887 (July 6, 1988). See also Payment for Order Flow Final Rules, 59 FR at 55008–55009.

<sup>51</sup> Order Handling Rules Release, 61 FR at 48322–48333 ("In conducting the requisite evaluation of its internal order handling procedures, a broker-dealer must regularly and rigorously examine execution quality likely to be obtained from different markets or market makers trading a security."). See also *Newton*, 135 F.3d at 271; Market 2000: An Examination of Current Equity Market Developments V–4 (SEC Division of Market Regulation January 1994) ("Without specific instructions from a customer, however, a broker-dealer should periodically assess the quality of competing markets to ensure that its order flow is directed to markets providing the most advantageous terms for the customer's order.");

must examine their procedures for seeking to obtain best execution in light of market and technology changes and modify those practices if necessary to enable their customers to obtain the best reasonably available prices.<sup>52</sup> In doing so, broker-dealers must take into account price improvement opportunities, and whether different markets may be more suitable for different types of orders or particular securities.<sup>53</sup>

With respect to a DMM's obligations, the Exchange would require DMMs be subject to heightened standards as compared to other market makers. A DMM must provide continuous two-sided quotations throughout the trading day in all options classes in which the DMM is assigned, once the market maker indicates to the Exchange an intent to receive Directed Orders, for 90% of the time the Exchange is open for trading in each issue. Such quotations must meet the legal quote width requirements herein. These obligations will apply to all of the DMM's option issues collectively, rather than on an option-by-option basis. While the Market Maker's quoting requirement is a daily obligation, the Exchange is able to determine compliance with these obligations on a monthly basis. BX Regulation may consider exceptions to the requirement to quote 90% (or higher) of the trading day based on demonstrated legal or regulatory requirements or other mitigating circumstances. However, determining compliance with the continuous quoting requirement on a monthly basis does not relieve a DMM of the obligation to provide continuous two-sided quotes on a daily basis, nor will it prohibit the Exchange from taking disciplinary action against a DMM for failing to meet the continuous quoting obligation each trading day.

The Exchange believes that offering DMMs participation entitlements promotes just and equitable principles of trade because DMMs will be held to a higher standard as compared to other

Payment for Order Flow Final Rules, 59 FR at 55009.

<sup>52</sup> Order Handling Rules, 61 FR at 48323.

<sup>53</sup> Order Handling Rules, 61 FR at 48323. For example, in connection with orders that are to be executed at a market opening price, "[b]roker-dealers are subject to a best execution duty in executing customer orders at the opening, and should take into account the alternative methods in determining how to obtain best execution for their customer orders." Disclosure of Order Execution and Routing Practices, Securities Exchange Act Release No. 43590 (November 17, 2000), 65 FR 75414, 75422 (December 1, 2000) (adopting new Exchange Act Rules 11Ac1–5 and 11Ac1–6 and noting that alternative methods offered by some Nasdaq market centers for pre-open orders included the mid-point of the spread or at the bid or offer).

<sup>44</sup> See Securities Exchange Act Release No. 51759 (May 27, 2005), 70 FR 32860 (June 6, 2005) (SR-Phlx-2004–91).

<sup>45</sup> See note 20. Price Improving Orders, provide for investors the opportunity to trade at a better price than would otherwise be available—inside the disseminated best bid and offer for a security. The opportunity for investors to receive executions inside the disseminated best bid or offer could result in better executions for investors.

<sup>46</sup> See BX Chapter III, Section 4, Prevention of the Misuse of Material Nonpublic Information. BX prohibits an order flow provider from notifying a DMM of its intention to submit a directed order so that the DMM could change its quotation to match the national best bid or offer ("NBBO") immediately prior to the submission of the directed order.

<sup>47</sup> The Exchange will submit a letter detailing its surveillance and enforcement to the Commission.

<sup>48</sup> See, e.g., *Newton v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 135 F.3d 266, 269–70, 274 (3d Cir.), *cert. denied*, 525 U.S. 811 (1998); *Certain Market Making Activities on Nasdaq*, Securities Exchange Act Release No. 40900 (January 11, 1999) (settled case) (citing *Sinclair v. SEC*, 444 F.2d 399



market participants including market makers. A market maker would be required, pursuant to this proposal, to quote 60% of the trading day. DMMs are being held to a higher obligation and therefore are being rewarded with participation entitlements. Similar to market makers, DMMs add value through continuous quoting<sup>54</sup> and the commitment of capital. In addition, the DMM quoting requirements promote liquidity and continuity in the marketplace in requiring DMMs to be held to a higher standard of quoting. The Exchange also believes that the proposed rule change supports the quality of the Exchange's markets because it maintains the quoting obligations of market makers as DMMs at 90%. DMM transactions must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. Accordingly, the proposed rule change supports the quality of the Exchange's trading markets by helping to ensure that DMMs will be required to meet a higher quoting standard in order to reap the benefits of the participation entitlements. The Exchange believes this proposed change to offer participation entitlements to DMMs is offset by DMMs' continued responsibilities to provide significant liquidity to the market to the benefit of market participants.

The Exchange also notes that it believes that while rounding is up or down to the nearest integer, thereby having the potential to result in an allocation that is slightly greater than 40% of the remaining interest, this concept is not novel. Today, the rounding is computed in the same manner for LMM allocations, thereby resulting in the potential for slightly greater than 40% of remaining allocation for the LMM. It is also important to note that if the rounding results in computing the nearest lower integer, the DMM would receive slightly less than the percentages noted herein. The Exchange believes that the manner in which it rounds is not an impediment to a free and open market and a national market system. The rounding

computation described herein is consistent with the manner in which rounding is computed on BX's System, where appropriate. The Exchange applies the rounding methodology in all BX functionality related to allocation computations, not just in relation to DMM allocation computations. The Exchange believes that its method of rounding is transparent, just and equitable. The rounding provisions, unlike the allocation provisions, are not a guarantee but simply the result of a mathematical computation that can only be computed after the transactions are executed. The Exchange's proposal is focused on the guarantees that a DMM could expect as a result of quoting competitively, that is, quoting at or better than the NBBO. The rounding outcome is not guaranteed and is only the result of necessity of allocating shares in a just, equitable and transparent manner to market participants.

The proposed rule change also removes impediments to and allows for a free and open market, while protecting investors, by promoting transparency regarding DMMs' obligations and benefits in the Exchange Rules. In addition, the Exchange believes that the proposed rule change is designed to not permit unfair discrimination among DMMs.

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The competition among the options exchanges is vigorous and this proposal is intended to afford the BX Options market the opportunity to compete for directed order flow. In that regard, the proposal is pro-competitive and will offer market participants an additional venue for the execution of Directed Orders. The Exchange does not believe the proposal imposes a burden on intra-market competition not necessary or appropriate in furtherance of the purposes of the Act, because the ability to send Directed Orders is available to all Participants, and the ability to become a DMM is available to all market makers. Further, the Exchange does not believe the proposal will negatively impact quote competition on BX and create an unfair burden on competition. The directed order will be allocated based on the competitive bidding of market participants. A DMM will have to be quoting at the NBBO at the time the order is received to capitalize on the guarantee.

DMMs will be subject to enhanced quoting obligations and the obligations would apply to all options classes, once the market maker indicates to the Exchange an intent to receive Directed Orders, for 90% of the time the Exchange is open for trading in each issue collectively to all appointed issues, rather than on an option-by-option basis and compliance with this obligation will be determined on a monthly basis. Further, the proposal will not diminish, and in fact may increase, market making activity on the Exchange and thereby enhance intermarket competition. Moreover, the proposed rule change will not impose any burden on intra-market competition because it will affect all DMMs the same. DMMs will be subject to heightened quoting obligations as compared to other BX market makers. All market makers may become DMMs.

The Exchange does not believe the proposed rule change will cause any unnecessary burden on intra-market competition because it provides all market makers the opportunity to benefit from participation entitlements as a DMM. The Exchange believes that the proposed rule change will promote competition among market participants to the benefit of the Exchange, its Members, and market participants. This proposal puts in place a structure by which all Options Participants can both compete for order flow by contributing to price and size discovery for the entire market. Further, market makers must enter orders that assume the risk of trading with all participants at NBBO without knowing the details of the particular order. Market makers are incentivized to aggressively quote at the NBBO with this proposal to the benefit of all market participants, while maintaining their quoting obligations. The Exchange believes the proposal will encourage greater order flow to be sent to the Exchange through Directed Orders and that this increased order flow will benefit all market participants on the Exchange. The Exchange is not limiting the class of market participants that can be directed orders, any market maker may apply to receive directed orders and those market participants would be required to meet the heightened standards for quoting. DMMs must meet additional quoting and other regulatory obligations compared to certain other Exchange Participants and have thus demonstrated a commitment to providing liquidity on the Exchange. The Exchange believes that limiting the benefit of the participation entitlement to DMMs is fair and reasonable because

<sup>54</sup> Pursuant to Chapter VII (Market Participants), Section 5 (Obligations of Market Makers), in registering as a market maker, an Options Participant commits himself to various obligations. Transactions of a market maker in its market making capacity must constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and market makers should not make bids or offers or enter into transactions that are inconsistent with such course of dealings. See Chapter VII, Section 5. Further, all market makers are designated as specialists on BX for all purposes under the Act or rules thereunder. See Chapter VII, Section 2.



these DMMs must satisfy additional quoting and other obligations.

The Exchange does not believe the proposed change will cause any unnecessary burden on inter-market competition because all market makers are entitled to receive participation entitlements provided they direct orders and those orders are executed by those DMMs. In addition, the Exchange believes that the proposed rule change will in fact promote competition. The Exchange believes allowing DMMs to receive participation entitlements will promote trading activity on the Exchange because it will provide incentives to DMMs to quote in series which they are not obligated to do so, to the benefit of the Exchange, its Members, and market participants.

The Exchange does not believe that the method in which it rounds up or down to the nearest integer creates an undue burden on competition. The rounding outcome is not guaranteed and is only the result of necessity of allocating shares in a just, equitable and transparent manner to market participants.

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

No written comments were either solicited or received.

**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 (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) By order approve or disapprove such 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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-BX-2014-049 on the subject line.

*Paper Comments*

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

All submissions should refer to File Number SR-BX-2014-049. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for 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 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BX-2014-049, and should be submitted on or before January 2, 2015.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>55</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

[FR Doc. 2014-29109 Filed 12-11-14; 8:45 am]

**BILLING CODE 8011-01-P**

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-73779; File No. SR-NSCC-2014-12]

**Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Proposed Rule Change to Amend NSCC's Rules and Procedures in Connection with the Discontinuance of the Analytic Reporting Service**

December 8, 2014.

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 November 25, 2014, National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Item I, II and III below, which Items have been prepared by NSCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change**

The proposed rule change consists of amendments to Rule 57 (Insurance and Retirement Processing Services) and Addendum A (Fee Structure) of NSCC's Rules & Procedures in connection with the discontinuance of the Analytic Reporting Service, as more fully described below. The text of the proposed rule change is available on NSCC's Web site at <http://www.dtcc.com/legal/sec-rule-filings.aspx>, at the principal office of NSCC, and at the Commission's Public Reference Room.

**II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, NSCC 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. NSCC has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

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

<sup>55</sup> 17 CFR 200.30-3(a)(12).