SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations: NASDAQ OMX BX, Inc.; Order Granting Approval of a Proposed Rule Change, as Modified by Amendment Nos. 1 and 2, Relating to the Establishment of a New Options Market, NASDAQ OMX BX Options


I. Introduction

On May 1, 2012, NASDAQ OMX BX, Inc. (“Exchange” or “BX”) filed with the Securities and Exchange Commission (“Commission”) a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”), and Rule 19b–4 thereunder, to adopt rules governing the trading of options on NASDAQ OMX BX Options (“BX Options”), which will be an options trading facility of the Exchange. On May 8, 2012, BX filed Amendment No. 1 to the proposed rule change. The proposed rule change, as modified by Amendment No. 1, was published for comment in the Federal Register on May 18, 2012. The Commission received one comment letter on the proposal. The Exchange responded to the comment letter on June 15, 2012. On June 22, 2012, BX filed Amendment No. 2 to the proposed rule change. This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2 thereto.

II. Discussion and Commission Findings

After careful review of the proposal, as modified by Amendment Nos. 1 and 2, and consideration of the comment letter and the Exchange’s response thereto, the Commission finds that the proposed rule change, as modified by Amendment Nos. 1 and 2, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices; to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities; to remove impediments to and perfect the mechanism of a free and open market and a national market system; and, in general, to protect investors and the public interest. Section 6(b)(5) also requires that the rules of an exchange not be designed to permit unfair discrimination among customers, issuers, brokers, or dealers. Further, the Commission finds that the proposal is consistent with Sections 6(b)(1) of the Act, which requires, among other things, that a national securities exchange be so organized and have the capacity to carry out the purposes of the Act, and to comply and enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulation thereunder, and the rules of the exchange.

This discussion does not review every detail of the proposal, but focuses on the most significant rules and policy issues considered in review of the proposal.

A. BX Options Participants

BX Options will operate a fully automated electronic trading system for trading options (“System” or “BX Options System”). BX Options will have only one category of members, known as “Options Participants” or “Participants.” Only Options Participants will be permitted to transact business on the BX Options System. There will be two categories of Options Participants: (1) Options Order Entry Firms (“OEFs”) and (2) Options Market Makers. An Options Participant must be a member of the Exchange and another registered options exchange that is not registered solely under Section 6(g) of the Act or the Financial Industry Regulatory Authority (“FINRA”). Further, an OEF may only transact business with public customers if such Options Participant also is a member of another registered national securities exchange or association with which the Exchange has entered into an agreement under Rule 17d–2 under the Act pursuant to which such other exchange or association shall be the designated options examining authority for the OEF. In addition, Options Participants that transact business with Public Customers must at all times be members of FINRA.

Among other things, each Options Participant must be registered as a broker-dealer and have as the principal purpose of being an Options Participant the conduct of a securities business, which shall be deemed to exist if and so
supervises and administers the regulatory functions of the Exchange, may suspend or terminate any registration of an Options Market Maker when, in its judgment, the interest of a fair and orderly market are best served by such action.26

Options Market Makers are required to electronically engage in a course of dealings to enhance liquidity available on BX Options and to assist in the maintenance of fair and orderly markets.27 Among other things, an Options Market Maker must: (1) On a daily basis participate in the pre-opening phase and thereafter maintain a two-sided market on a continuous basis in at least 60% of the options series in which it is registered; (2) enter a size of at least one contract for its best bid and its best offer; and (3) maintain minimum net capital in accordance with Commission and Exchange rules.28 Substantial or continued failure by an Options Market Maker to meet any of its obligations and duties would subject the Options Market Maker to disciplinary action, suspension, or revocation of the Options Market Maker’s registration in one or more options series.29

The Commission finds that the BX Options Market Maker qualification requirements are consistent with the Act and notes that they are similar to those of other options exchanges.30 The Commission also finds that the BX Options Market Maker participation requirements are consistent with the Act. Market makers receive certain benefits for carrying out their affirmative obligations, including the 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. The Commission believes that BX Options Market Maker participation requirements impose sufficient affirmative obligations on BX Options Market Makers and, accordingly, that these BX Options requirements are consistent with the Act.32

B. BX Options Trading System

The BX Options System will leverage current technology, including customer connectivity, messaging protocols, quotation and execution engine, order router, data feeds, and network infrastructure of the various markets owned by The NASDAQ OMX Group, Inc. ("NASDAQ OMX"). As a result, BX Options System will closely resemble NOM.33 As noted above, the BX Options System will be an electronic trading system to trade options that will provide for the electronic display and automatic execution of orders in price/time priority, without regard to the status of the entities that are entering orders.34 The System will include two proprietary data feeds. BX Depth of Market ("BX Depth") will be a data feed that provides quotation information for individual orders on the BX Options book, last-sale information for trades executed on BX Options, and order imbalance information as set forth in BX Options Rules Chapter VI, Section 8.35 In addition, BX Top of Market ("BX Top") will be a data feed that provides the BX Options best bid and offer and last-sale information for trades executed on BX Options.36

Options Participants will be able to enter the following types of orders into

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23 See proposed BX Options Rules, Chapter II, Section 1(a)(7).
24 See, e.g., proposed BX Options Rules, Chapter VII, Sections 5 and 6; and BATS Rules 22.5 and 22.6.
25 See Notice, supra note 4, for a more complete description of BX Options operation and rules. The Commission notes that the participation requirements are similar to those of other options exchanges. See, e.g., NOM Rules, Chapter VII, Sections 5 and 6; and BATS Rules 22.5 and 22.6.
26 See proposed BX Options Rules, Chapter VII, Sections 5 and 6; and BATS Rules 22.4, 22.5 and 22.6.
27 See, e.g., Rules of NOM, Chapter VII, Sections 4, 5, and 6; and BATS Rules 22.4, 22.5 and 22.6.
28 See 12 CFR 221.5 and 12 CFR 220.7; see also 17 CFR 240.15c–3(a)(6) (capital requirements for market makers).
29 See proposed BX Options Rules, Chapter VI, Section 8.35
30 See proposed BX Options Rules, Chapter VI, Section 8.35
31 See BX Options Rules, Chapter VII, Section 8.35
32 See proposed BX Options Rules, Chapter VII, Section 8.35
33 See proposed BX Options Rules, Chapter VII, Section 8.35
34 See proposed BX Options Rules, Chapter VII, Section 8.35
35 See proposed BX Options Rules, Chapter VII, Section 8.35
36 See proposed BX Options Rules, Chapter VII, Section 8.35
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 or below the current inside offer price. For orders to sell, at the time it is entered into the System, the order is priced at or above the current inside bid price. See proposed BX Options Rules, Chapter VI, Section 1(e)(4).

38 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(3).

39 Market Orders are orders to buy or sell at the current market price that is superior to the limit price of the ISO, which such additional orders also mark the ISO as an ISO. See proposed BX Options Rules, Chapter XII, Section 1(f)(10). Orders may have any time-in-force designation except WAIT. See Amendment No. 1. ISOs with a time-in-force designation of Good Til canceled ("GTC") are treated as having a time-in-force designation of Day. See id. ISOs that are marked as Day or GTC lose the ISO designation in that security. Price Improving Orders may be entered in increments as small as one cent. Price Improving Orders at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(6).

40 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 at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(5).

41 Intermarket Sweep Orders ("ISOs") means a limit order for an options series that: (1) when routed to an eligible exchange, the order is identified as an ISO; and (2) 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 buy, or any protected offer, in the case of a limit order to sell, for the options series with a price that is superior to the limit price of the ISO, which such additional orders also mark the ISO as an ISO. See proposed BX Options Rules, Chapter XII, Section 1(f)(10). ISOs may have any time-in-force designation except WAIT. See Amendment No. 1. ISOs with a time-in-force designation of Good Til canceled ("GTC") are treated as having a time-in-force designation of Day. See id. ISOs that are marked as Day or GTC lose the ISO designation in that security. Price Improving Orders may be entered in increments as small as one cent. Price Improving Orders at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(6).

42 Post-Only Orders are orders that will not execute against another order in the System unless the order is priced at the minimum price variation. Post-Only Orders are orders that are 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(10).

43 All-or-none Orders are market or limit orders which are 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(10).

44 One-cancels-the-other Orders are orders entered into a Market bucket that consists of a buy order and a sell order treated as a unit; the full execution of one of the orders causes the other to be canceled. See proposed BX Options Rules, Chapter VI, Section 1(e)(9).

45 Price Improving Orders are orders to buy or sell an option at a specified price at a price 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 at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(5).

46 Intermarket Sweep Orders ("ISOs") means a limit order for an options series that: (1) when routed to an eligible exchange, the order is identified as an ISO; and (2) 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 buy, or any protected offer, in the case of a limit order to sell, for the options series with a price that is superior to the limit price of the ISO, which such additional orders also mark the ISO as an ISO. See proposed BX Options Rules, Chapter XII, Section 1(f)(10). ISOs may have any time-in-force designation except WAIT. See Amendment No. 1. ISOs with a time-in-force designation of Good Til canceled ("GTC") are treated as having a time-in-force designation of Day. See id. ISOs that are marked as Day or GTC lose the ISO designation in that security. Price Improving Orders may be entered in increments as small as one cent. Price Improving Orders at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(6).

47 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(3).

48 Market Orders are orders to buy or sell at the best price available at the time of execution. Participants may designate that their Market Orders not executed after a pre-established period of time will be handled pursuant to proposed BX Options, Chapter VI, Section 10(6).

49 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 at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(5).

50 Intermarket Sweep Orders ("ISOs") means a limit order for an options series that: (1) when routed to an eligible exchange, the order is identified as an ISO; and (2) 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 buy, or any protected offer, in the case of a limit order to sell, for the options series with a price that is superior to the limit price of the ISO, which such additional orders also mark the ISO as an ISO. See proposed BX Options Rules, Chapter XII, Section 1(f)(10). ISOs may have any time-in-force designation except WAIT. See Amendment No. 1. ISOs with a time-in-force designation of Good Til canceled ("GTC") are treated as having a time-in-force designation of Day. See id. ISOs that are marked as Day or GTC lose the ISO designation in that security. Price Improving Orders may be entered in increments as small as one cent. Price Improving Orders at prices 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(6).

51 Post-Only Orders are orders that will not execute against another order in the System unless the order is priced at the minimum price variation. Post-Only Orders are orders that are 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(10).

52 One-cancels-the-other Orders are orders entered into a Market bucket that consists of a buy order and a sell order treated as a unit; the full execution of one of the orders causes the other to be canceled. See proposed BX Options Rules, Chapter VI, Section 1(e)(9).

53 All-or-none Orders are market or limit orders which are 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(10).

54 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 and functionality identical to what is currently approved for use on NOM. Options entered into the System will be designated for display (price and size) on an anonymous basis in the order display service of the System. Options Participants will be permitted to enter multiple orders at single or multiple price levels. All trading interest on the System will be automatically executable. The System will have a single execution algorithm based on price/time priority. The System and BX Options Rules provide for the ranking, display, and execution of all orders in price/time priority without regard to the status of the entity entering an order. For each order, among equally-priced or better-priced trading interest, the System executes against available contra-side contract amounts in full, in price/time priority. Any price improvement resulting from an execution in the System will accrue to the party taking liquidity.

55 Quotes and orders entered by Options Market Makers will not be executed against quotes and orders entered on the opposite side of the market by the same market maker using the same identifier. In such a case, the System will cancel the oldest of the quotes or orders back to the entering party prior to execution. The Commission believes that BX Options’ proposed execution priority rules and order types are consistent with other rules 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 proposed BX Options, Chapter VI, Section 7(b)(3)(C). 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. See proposed BX Options Rules, Chapter VI, Section 1(e)(10).

56 The Commission notes that BX is required under Rule 608(c) of Regulation NMS to comply with and enforce compliance by its members with the Linkage Plan, including the requirement to avoid trading through better prices available on other markets. Further, any order entered with a price that would lock or cross a protected quotation that is not eligible for routing, will be re-priced to the current national best offer (for bids) or the current national best bid (for offers) and displayed at one minimum price variance above (for offers) or below (for bids) the national best price.

57 One commenter expressed concern with the timing of the proposal and requested that the Commission amend CBOE Options, Incorporated ("C2") temporary relief from the Linkage Plan. Specifically, the commenter noted that CBOE and C2 will not be able to complete required systems work by BX Options’ anticipated launch date of June 29, 2012 to allow these exchanges to identify better-priced quotations on BX Options and then cancel or route orders to BX Options in compliance with the Linkage Plan. Consequently, the commenter stated that these exchanges may not be able to comply with the Linkage Plan because their systems will potentially trade through better-priced quotations on BX Options. The commenter requested temporary relief from the Linkage Plan so that CBOE and C2 will...
be able to continue to operate consistent with the terms of the Linkage Plan until it can implement the necessary systems changes. While BX believes that the notice provided to CBOE and the marketplace in general was sufficient and consistent with customary timeframes respecting systems changes of this sort, BX acknowledged the commenter’s concerns and stated that temporary relief from the Linkage Plan warrants consideration.56

As noted below, BX will be a participant in the Linkage Plan. To meet their regulatory responsibilities under the Linkage Plan, including the requirement to avoid trading through better-priced protected quotations available on other markets, other options exchanges that are Linkage Plan participants must have sufficient notice of new protected quotations, as well as all necessary information (such as final technical specifications). Therefore, the Commission believes that it would be a reasonable policy and procedure under the Linkage Plan for options exchanges to begin treating BX Options’ best bid and best offer as a protected quotation within 60 days after the date of this order. Proposed BX Options Rules, Chapter VII, Section 12, prohibits Options Participants from executing, as principal, orders they represent as agent unless the agency order is first exposed on BX Options for at least one second or the Options Participant has been bidding or offering on BX Options for at least one second prior to receiving an agency order that is executable against such bid or offer.

The Commission believes that in the electronic environment of BX Options, a one second exposure period could facilitate the prompt execution of orders while continuing to provide Options Participants with an opportunity to compete for exposed bids and offers. In addition, the BX Options System is identical to the trading system currently used for NOM today and this order exposure requirement is comparable to that which currently applies on other registered options exchanges.57 Accordingly, the Commission believes this proposed rule of BX Options is consistent with the Act.

C. Opening and Halt Cross

The System will support a single price opening or re-opening via an electronic cross.58 The auctions at the opening and at the resumption of trading following a halt are identical to those that exist on NOM.

Specifically, BX Options will operate a pre-opening phase that will begin prior to the opening of the market at a time to be determined by the Exchange. Orders may be submitted, modified, and cancelled throughout the pre-opening phase. Prior to opening the market (or resuming trading in the case of a halt), the Exchange will calculate and disseminate certain indicative information: Opening price; order imbalance; and the size and direction of any imbalance. Thereafter, the Exchange will determine, using an algorithm, a single price at which a particular options series will open and will match, using an algorithm, the maximum number of available orders. After the cross concludes, orders will be cancelled, routed, or posted depending on the instructions on the orders and open trading will commence.

The Commission believes that the proposed BX Options Rules, regarding the opening and pre-opening of trading on BX Options, are reasonably designed to provide for an orderly opening and are consistent with the Act. The Commission further believes that the procedure for re-opening trading in an option following the conclusion of a trading halt in the underlying security is reasonably designed to provide for an orderly re-opening of trading in the option and is consistent with the Act.

D. Routing

BX Options Participants may designate orders to be routed to another options exchange when trading interest is not available on BX Options or to execute only on BX Options. The Exchange proposed that its routing system be designed to limit only routing System securities, which are options listed for trading on BX. The Exchange has proposed to offer two System routing options: SEEK61 and SRCH,62 which may be combined with

all available order types and time-in-force designations, with the exception of order types and time-in-force designations whose terms are inconsistent with the terms of a particular routing option.63 An order that is designated as routable will be routed to other options exchanges to be executed when BX Options is not at the NBBO consistent with the Linkage Plan. Orders routed to other options exchanges do not retain time priority with respect to orders in the System, and the System will continue to execute orders while routed orders are away at another exchange.64 If a routed order is returned, in whole or in part, that order (or its remainder) will receive a new time stamp reflecting the time of its return to the System.65

The Exchange will route options using NASDAQ Options Services LLC (“NOS”), which is a registered broker-dealer and a member of the Exchange.66 NOS is owned by NASDAQ OMX, which also owns three registered securities exchanges—the Exchange, NASDAQ, and NASDAQ OMX PHLX LLC (“PHLX”). Therefore, NOS is an affiliate of these exchanges.67

Exchange Rule 2140(a)(1) provides generally that, absent an effective filing contracts for execution. After checking the System for available contracts, orders are sent to other available market centers for potential execution, per the entering firm’s instructions. When checking the book, the System will seek to execute at the price at which it would send the order to a destination market center. If contracts remain un-executed after routing, they are posted on the book. Once on the book, should the order subsequently be locked or crossed by another market center, it will re-route. See proposed BX Options Rules, Chapter VI, Section 11(a)(1)(B).

See proposed BX Options Rules, Chapter VI, Section 11(a).

See proposed BX Options Rules, Chapter VI, Section 11(d).

See id.

See BX Response, supra note 6.

See, e.g., Rules of NOM, Chapter VII, Section 12.

See proposed BX Options Rules, Chapter VI, Section 8.

See proposed BX Options Rules, Chapter VI, Section 6.

SEEK is a routing option pursuant to which an order will first check the System for available contracts for execution. After checking the System for available contracts, orders are sent to other available market centers for potential execution, per the entering firm’s instructions. When checking the book, the System will seek to execute at the price at which it would send the order to a destination market center. If contracts remain un-executed after routing, they are posted on the book. Once on the book, should the order subsequently be locked or crossed by another market center, the System will not route the order to the locking or crossing market center. See proposed BX Options Rules, Chapter VI, Section 11(a)(1)(A).

SRCH is a routing option pursuant to which an order will first check the System for available contracts for execution. After checking the System for available contracts, orders are sent to other available market centers for potential execution, per the entering firm’s instructions. When checking the book, the System will seek to execute at the price at which it would send the order to a destination market center. If contracts remain un-executed after routing, they are posted on the book. Once on the book, should the order subsequently be locked or crossed by another market center, the System will not route the order to the locking or crossing market center. See proposed BX Options Rules, Chapter VI, Section 11(a)(1)(A).

See BX Response, supra note 6.

See, e.g., Rules of NOM, Chapter VII, Section 12.

See proposed BX Options Rules, Chapter VI, Section 8.

See proposed BX Options Rules, Chapter VI, Section 11(a).

See id.

See proposed BX Options Rules, Chapter VI, Section 11(d).

See id.

See id.

See proposed BX Options Rules, Chapter VI, Section 11(c).

See Notice, supra note 4, at 29733. The Exchange represented that NOS has developed policies and procedures designed to reject an order or series of orders that violate applicable pre-trade requirements of Rule 15c3–5 under the Act prior to routing such orders, and therefore may not seek to cancel any orders that had been routed. See Notice, supra note 4, at 29734.


See id. See also Notice, supra note 4, at 29734.
under Section 19(b) of the Act, the Exchange may not, directly or indirectly, acquire or maintain an ownership interest in, or engage in a business venture with, an Exchange member or an affiliate of an Exchange member. However, the Exchange proposes that NOS, a member of the Exchange, provide other members of the Exchange options routing services to other markets, including two affiliates of the Exchange—NASDAQ and PHLX. In addition, the Exchange intends to receive through NOS options orders routed inbound to the Exchange from its affiliated exchanges. Accordingly, the Exchange seeks Commission approval to permit the Exchange to engage in the business venture of outbound routing using NOS as its routing broker, as well as receiving inbound orders from its affiliates, NASDAQ and PHLX, through NOS.

Recognizing that the Commission has previously expressed concern regarding the potential for conflicts of interest in instances where a member firm is affiliated with an exchange, particularly where a member is routing orders to such affiliated exchange, the Exchange has proposed limitations and conditions on NOS’s affiliation with the Exchange. Specifically, the Exchange proposes that NOS operate as outbound router and inbound router subject to certain limitations and conditions, as described below.

1. NOS as Outbound Router

The Exchange proposes that NOS will operate as a facility (as defined in section 3(a)(2) of the Act) of the Exchange to provide outbound options routing services from the Exchange to other options exchanges. NOS’s operation as a facility providing outbound options routing services for the Exchange is subject to the following limitations and conditions:

- NOS will route orders to other market centers as directed by the Exchange. NOS will be programmed to follow the algorithm and order type instructions established in the BX Options Rules and will not have discretion to change the terms of an order or the order routing instructions.
- NOS will not engage in any business other than: (a) as an outbound router for the Exchange; and (b) any other activities it may engage in as approved by the Commission.
- For purposes of Commission Rule 17d–1, the designated examining authority of NOS will be a self-regulatory organization (“SRO”) unaffiliated with the Exchange or any of its affiliates.
- The Exchange will be responsible for filing with the Commission proposed rule changes related to the operation of, and fees for services provided by, NOS and NOS shall be subject to exchange nondiscrimination requirements.
- The books, records, premises, officers, agents, directors and employees of NOS as a facility of the Exchange will be deemed to be the books, records, premises, officers, agents, directors and employees of the Exchange for purposes of, and subject to oversight pursuant to, the Act. The books and records of NOS as a facility of the Exchange will be subject at all times to inspection and copying by the Commission.
- The use of NOS to route options orders to other market centers will be optional. Parties who do not desire to use NOS must enter orders into the System as ineligible for routing.
- NOS will establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the Exchange and its facilities (including NOS as its routing facility) and any other entity.
- As a facility of the Exchange, NOS will be subject to the Exchange’s and the Commission’s regulatory oversight; and the Exchange will be responsible for ensuring that NOS’s outbound routing function is operated consistent with Section 6 of the Act and the Exchange’s rules. In addition, the Exchange will be required to file with the Commission proposed rule changes and fees relating

76 The Exchange also proposed that, immediately prior to the commencement of operations of NOS as an outbound router for the Exchange, the Exchange be approved to use NOS to conduct a test of its routing functionality. See Notice, supra note 4, at 29733–34. The Exchange represented that it will use NOS to perform test trades in an actual security to track the performance of its systems from order entry to clearance and settlement. See id. The Exchange represented that the test will be performed by entering a buy or sell order and then, upon execution of each, entering an offsetting buy and sell order in the same security for the same quantity to close out the test position and minimize financial impact on the Exchange. See id. The Exchange represented that it will deliver the test orders to NOS, as the routing broker, which will route to the designated away market and receive an execution back. See id. The Exchange represented that, to the extent that the offsetting trades require the Exchange to pay out funds, the funds will be provided out of the cash accounts of the Exchange; and, to the extent that the trades result in a profit, the funds will be deposited in the cash accounts of the Exchange. See id.


78 See supra note 76.


80 NOS also is subject to independent oversight by FINRA, its designated examining authority, for compliance with financial responsibility requirements. See Notice, supra note 4, at 29734.
identify NOS as a participant that has potentially violated Commission or the Exchange’s rules.

- The Exchange has in place BX Rule 2140(c), which requires NASDAQ OMX, as the holding company owning both the Exchange and NOS, to establish and maintain procedures and internal controls reasonably designed to ensure that NOS does not develop or implement changes to its systems as a result of its affiliation with the Exchange, until such time as the Commission believes that the Exchange’s proposed minimum quoting and trading increments, including its proposal to commence quoting pursuant to the Pilot Program, which are consistent with the rules of other options exchanges, are consistent with the Act. As the Commission noted in approving the latest expansion of the Pilot Program, allowing market participants to quote in smaller increments in Pilot options has been shown to reduce spreads, thereby lowering costs to investors. In addition, permitting options to be quoted in smaller increments pursuant to the Pilot Program provides the opportunity for reduced spreads for a significant amount of trading volume.

Further, although the Commission anticipates that the Exchange’s proposal will contribute to further increases in quotation message traffic, the Commission believes that the Exchange’s proposal is sufficiently limited such that it is unlikely on its own to increase quotation message traffic beyond the capacity of market participants’ systems.

F. Securities Traded on BX Options

The Exchange proposes to adopt initial and continued listing standards for equity and index options traded on BX Options that are substantially similar to the listing standards adopted by other options exchanges. The Commission believes that the Exchange’s proposed initial and continued listing standards are consistent with the Act, including Section 6(b)(5), in that they are designed to protect investors and the public interest and to promote just and equitable principles of trade.

G. Participation in National Market System Plans

The Exchange represented that it is a participant of various national market systems for options trading established under Section 11A of the Act. Specifically, the Exchange represented that it is a participant of the Linkage Plan, the OPRA Plan, the Plan for the Selection and Reservation of options contracts traded on BX Options would be one (1) cent for all series. The Commission believes that the Exchange’s proposed minimum quoting and trading increments, including its proposal to commence quoting pursuant to the Pilot Program, which are consistent with the rules of other options exchanges, are consistent with the Act.

The Exchange proposes the above limitations and conditions applicable to NOS’s inbound options routing activities. The Commission believes that these limitations and conditions mitigate its concerns about potential conflicts of interest and unfair competitive advantage. In particular, the Commission believes that a non-affiliated SRO oversight of NOS, combined with a non-affiliated SRO’s monitoring of NOS’s compliance with the Exchange’s rules and quarterly reporting to the Exchange, will help to protect the independence of the Exchange’s regulatory responsibilities with respect to NOS. The Commission also believes that the requirement that the Exchange establish and maintain procedures and internal controls reasonably designed to ensure that NOS does not develop or implement changes to its systems as a result of its affiliation with the Exchange, until such information is available generally to similarly situated members of the Exchange, is reasonably designed to ensure that NOS cannot misuse any information advantage it may have because of its affiliation with the Exchange. Furthermore, the Commission believes that the Exchange’s proposal to allow NOS to route options orders inbound to the Exchange from its affiliated exchanges (i.e., NASDAQ and PHLX), on a pilot basis, will provide the Exchange and the Commission with an opportunity to assess the impact of any conflicts of interest of allowing an affiliated member of an Exchange to route options orders inbound to the Exchange and whether such affiliation provides an unfair competitive advantage.

Further, the Commission notes that the proposed conditions for the operation of NOS as the affiliated inbound router on behalf of the Exchange are consistent with conditions the Commission has approved for other exchanges. The Commission therefore finds the proposed operation of NOS as an affiliated inbound router of the Exchange is consistent with the Act.

E. Minimum Quoting and Trading Increments

The Exchange is proposing to apply the following minimum quoting increments: (1) If the option price is less than $3.00, five (5) cents; and (2) if the option price is $3.00 or higher, ten (10) cents.

In addition, the Exchange proposes to participate in a pilot program, until June 30, 2012, to allow quoting in certain options in smaller increments (“Pilot Program”). The Exchange will include in the Pilot Program all classes that are, on that date, included by other options exchanges in substantially similar pilot programs. If an options class is included in the Pilot Program, the Exchange will allow quoting in one (1) cent increments any option priced less than $3.00 or options on QQQQ, IWM, and SPY. Options priced at $3.00 or higher that are in the Pilot Program will be quoted in five (5) cent increments. In addition, the Exchange is proposing that the minimum trading increment for

83 See supra note 70.
84 See supra note 70.
85 See supra note 70.
86 See supra note 70.
87 See supra note 70.
88 See supra note 70.
89 See supra note 70.
90 See supra note 70.
91 See supra note 70.
92 See supra note 70.
93 See supra note 70.
94 See supra note 70.
Securities Symbols, and the Plan of the Options Regulatory Surveillance Authority. BX represented that it will join the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options Submitted Pursuant to Section 11A(a)(3)(B) of the Act (“OLPP”).

H. Regulation

According to the Exchange, the Exchange will regulate BX Options using the existing BX regulatory structure. The Exchange’s CRO will have general supervision of the regulatory operations of BX Options, including responsibility for overseeing the surveillance, examination, and enforcement functions and for administering all regulatory services agreements applicable to BX Options. Similarly, the Exchange’s existing Regulatory Oversight Committee (“ROC”) will be responsible for overseeing the adequacy and effectiveness of the Exchange’s regulatory and SRO responsibilities, including those applicable to BX Options.

As members of the Exchange, the Exchange’s proposed rules and regulatory structure with respect to BX Options are consistent with the requirements of the Act, and in particular with Section 6(b)(1) of the Act, which requires an exchange to be so organized and have the capacity to be able to carry out the purposes of the Act and to comply, and to enforce compliance by its members and persons associated with its members, with the Act and the rules and regulations thereunder, and the rules of the Exchange. With and with Section 6(b)(6) and 6(b)(7) of the Act, which require an Exchange to provide fair procedures for the disciplining of members and persons associated with members.

1. Regulatory Services Agreement

Currently, the Exchange and FINRA are parties to an existing RSA, pursuant to which FINRA personnel operate as agents for the Exchange in performing certain functions. According to the Exchange, FINRA performs certain membership, disciplinary, and enforcement functions for the Exchange. The Exchange represented that the Exchange and FINRA have modified the RSA to capture aspects of regulation specifically applicable to BX Options and the regulation and discipline of Options Participants. The Exchange will continue to bear ultimate regulatory responsibility for functions performed on the Exchange’s behalf under the RSA. Further, the Exchange retains ultimate legal responsibility for the regulation of its Options Participants and its market.

The Commission believes that it is consistent with the Act to allow the Exchange to contract with FINRA to perform examination, enforcement, and disciplinary functions. These functions are fundamental elements to a regulatory program and constitute core self-regulatory functions. The Commission believes that FINRA has the expertise and experience to perform these functions on behalf of the Exchange.

As noted, unless relieved by the Commission of its responsibility, the Exchange bears the responsibility for self-regulatory conduct and primary liability for self-regulatory failures, not the SRO retained to perform regulatory functions on the Exchange’s behalf. In performing these functions, however, FINRA may nonetheless bear liability for causing or aiding and abetting the failure of the Exchange to perform its regulatory functions. Accordingly,
although FINRA will not act on its own behalf under its SRO responsibilities in carrying out these regulatory services for the Exchange relating to the operation of BX Options, FINRA also may have secondary liability if, for example, the Commission finds the contracted functions are being performed so inadequately as to cause a violation of the federal securities laws by the Exchange.115

2. 17d–2 Agreements

Rule 17d–2 under the Act permits SROs to file with the Commission plans under which the SROs allocate among each other the responsibility to receive regulatory reports from, and examine and enforce compliance with specified provisions of the Act and rules thereunder and SRO rules by, firms that are members of more than one SRO ("common members"). If such a plan is declared effective by the Commission, an SRO that is a party to the plan is relieved of regulatory responsibility as to any common member for whom responsibility is allocated under the plan to another SRO.116

Pursuant to Rule 17d–2 under the Act, all of the options exchanges, FINRA, and the New York Stock Exchange LLC ("NYSE") have entered into the Options Sales Practices Agreement, a Rule 17d–2 Agreement, which allocates to certain SROs ("examining SROs") regulatory responsibility for common members with respect to certain options-related sales practice matters.117 Under this Agreement, the examining SROs would examine firms that are common members of the Exchange and the particular examining SRO for compliance with certain provisions of the Act, certain of the rules and regulations adopted thereunder, certain examining SRO rules, and certain Exchange Rules. The Exchange's rules contemplate participation in this Agreement by requiring that any Options Participant also be a member of at least one of the examining SROs.118

Moreover, pursuant to Rule 17d–2 under the Act, all of the options exchanges and FINRA have entered into the Options Related Market Surveillance Agreement, which allocates regulatory responsibility for certain options-related market surveillance matters among the participants.119 Under this agreement, the examining SRO would assume regulatory responsibility with respect to firms that are common members of the Exchange and the particular examining SRO for compliance with applicable common rules for certain accounts. As a condition to operation, the Exchange must be a party to each of these 17d–2 Agreements, which will cover BX members that are Options Participants. The Exchange represented that it is a party to each of these 17d–2 Agreements.120

3. Minor Rule Violation Plan

The Commission approved the Exchange’s Minor Rule Violation Plan ("MRVP") in 1989.121 The Exchange’s MRVP specifies those uncontested minor rule violations with sanctions not exceeding $2,500 that would not be subject to the provisions of Rule 19d–1(c)(1) under the Act 122 requiring that an SRO promptly file notice with the Commission of any final disciplinary action taken with respect to any person or organization.123 The Exchange’s MRVP includes the policies and procedures included in BX Rule 9216(b), "Procedures for Violations under Plan Pursuant to SEC Rule 19d–1(c)(2)," and the rule violations included in BX IM–9216, "Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d–1(c)(2)," as amended.

The Exchange proposes to amend its MRVP and BX IM–9216 to include references to proposed BX Options Rules, Chapter X, Section 7. "Penalty for Minor Rule Violations for Options Trading."124 The Commission believes that this change is consistent with the Act because it clarifies that the proposed rules listed in Chapter X, Section 7 of the proposed BX Options Rules will be included in BX’s MRVP.

The Commission notes that the rules included in proposed BX Options Rules, Chapter X, Section 7 are similar to rules included in the MRVPs of other options exchanges.125 The Commission finds that the BX MRVP, as amended to include the rules listed in proposed BX Options Rules, Chapter X, Section 7, is consistent with Sections 6(b)(1), 6(b)(5), and 6(b)(6) of the Act, which require, in part, that an exchange have the capacity to enforce compliance with, and provide appropriate discipline for, violations of the rules of the Commission and of the exchange.126 In addition, because BX Rule 9216(b) will offer procedural rights to a person sanctioned for a violation listed in proposed BX Options Rules, Chapter X, Section 7, the Commission believes that the Exchange’s rules provide a fair procedure for the disciplining of members and associated persons, consistent with Section 6(b)(7) of the Act.127

The Commission also finds that the proposal to include the provisions in proposed BX Options Rules, Chapter X, Section 7 in BX’s MRVP is consistent with the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Act, as required by Rule 19d–1(c)(2) under the Act,128 because it should strengthen the Exchange’s ability to fulfill its oversight and enforcement responsibilities as an SRO in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation.

In approving the proposed change to the Exchange’s MRVP, the Commission in no way minimizes the importance of compliance with the Exchange’s rules and all other rules subject to the imposition of fines under the Exchange’s MRVP. The Commission believes that the violation of any SRO rules, as well as Commission rules, is a serious matter. However, the Exchange’s MRVP provides a reasonable means of addressing rule violations that do not rise to the level of requiring formal


116 See Rule 17d–2.

117 Any two or more SROs may file with the Commission a plan for allocating among such SROs the responsibility to receive regulatory reports from persons who are members or participants of more than one of such SROs to examine such persons for compliance, or to enforce compliance by such persons, with specified provisions of the Act, the rules and regulations thereunder, and the rules of such SROs, or to carry out other specified regulatory functions with respect to such persons. See 17 CFR 240.17d–2.


120 See Amendment No. 2, supra note 7.


122 17 CFR 240.19d–1(c)(1).

123 The Commission adopted amendments to paragraph (c) of Rule 19d–1 to allow SROs to submit for Commission approval plans for the abbreviated reporting of minor disciplinary infractions. Securities Exchange Act Release No. 21013 (June 1, 1984), 49 FR 23628 (June 8, 1984) (File No. S7–983). Any disciplinary action taken by an SRO against any person for violation of a rule of the SRO which has been designated as a minor rule violation pursuant to such a plan filed with and declared effective by the Commission would not be considered "final" for purposes of Section 19d–1.

124 See Notice, supra note 4, at 29736–37.

125 See, e.g., Rules of NOM, Chapter X, Section 7.

126 15 U.S.C. 78b(b)(1), 78b(b)(3), and 78b(b)(6).


disciplinary proceedings, while providing greater flexibility in handling certain violations. The Commission expects that the Exchange will continue to conduct surveillance with due diligence and make a determination based on its findings, on a case-by-case basis, whether a fine of more or less than the recommended amount is appropriate for a violation under the Exchange’s MRVP or whether a violation requires a formal disciplinary action.

I. Section 11(a) of the Act

Section 11(a)(1) of the Act prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion (collectively, “covered accounts”) unless an exception applies. Rule 11a2–2(T) under the Act, known as the “effect versus execute” rule, provides exchange members with an exemption from the Section 11(a)(1) prohibition. Rule 11a2–2(T) permits an exchange member to effect transactions for covered accounts by arranging for an unaffiliated member to execute transactions on the exchange. To comply with Rule 11a2–2(T)'s conditions, a member: (i) Must transmit the order from off the exchange floor; (ii) may not participate in the execution of the order once it has been transmitted to the member performing the execution; (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the Rule.

In a letter to the Commission, the Exchange requests that the Commission concur with the Exchange’s conclusion that Options Participants that enter orders into the System satisfy the requirements of Rule 11a2–2(T). For the reasons set forth below, the Commission believes that Options Participants entering orders into the System would satisfy the conditions of the Rule. The Rule’s first condition is that orders for covered accounts be transmitted from off the exchange floor. The BX Options System will receive orders electronically through remote terminals or computer-to-computer interfaces. In the context of other automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange’s floor by electronic means. Because the BX Options System receives orders electronically through remote terminals or computer-to-computer interfaces, the Commission believes that the System satisfies the off-floor transmission requirement. Second, the Rule requires that the member not participate in the execution of its order once it has been transmitted to the member performing the execution. The Exchange represented that at no time following the submission of an order is an Options Participant able to influence the result or timing of an order’s execution. According to the Exchange, the execution of a member’s order is determined solely by what other orders, bids, or offers are present in the System at the time the Options Participant submits the order and on the priority of those orders, bids, and offers. Accordingly, the Commission believes that an Options Participant does not participate in the execution of an order submitted to the System. Third, Rule 11a2–2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that this requirement is satisfied when automated exchange facilities are used, as long as the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange. BX represented that the design of the System ensures that no Options Participant has any special or unique trading advantage in the handling of its orders after transmitting its orders to the Exchange. Based on the Exchange’s representation, the Commission believes that the BX Options System satisfies this requirement.

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

In considering the operation of automated execution systems operated by an exchange, the Commission has noted that while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted into the System. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2–2(T). See 1979 Release, supra note 133.

133 17 CFR 240.11a2–2(T).
134 The member may, however, participate in clearing and settling the transaction.
135 See Letter from Jeffrey S. Davis, Vice President and Deputy General Counsel, NASDAQ OMX, to Heather Seidel, Associate Director, Division of Trading and Markets, Commission, dated June 19, 2012 (“BX 11(a) Letter”).
137 See BX 11(a) Letter, supra note 132, at 7.
138 See id. An Options Participant may cancel or modify the order, or modify the instruction for executing the order, but only from off the floor. The Commission has stated that the non-participation requirement is satisfied under such circumstances, so long as such modifications or cancellations are also transmitted from off the floor. See Securities Exchange Act Release No. 14713 (April 27, 1978), 43 FR 18557 (May 1, 1978) (“1978 Release”) (stating that the “non-participation requirement does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor”).
139 See Section 11(a)(1) of the Act, supra note 132, at 8.
III. Exemption From Section 19(b) of the Act With Regard to CBOE, NYSE, and FINRA Rules Incorporated by Reference

The Exchange proposes to incorporate by reference as BX Options Rules certain rules of the CBOE, NYSE, and FINRA.\(^{140}\) Thus, for certain BX Options rules, Exchange members will comply with a BX Options rule by complying with the CBOE, NYSE, or FINRA rule referenced. In connection with its proposal to incorporate CBOE, NYSE, and FINRA rules by reference, the Exchange requested, pursuant to Rule 240.0–12 under the Act,\(^ {141}\) an exemption under Section 36 of the Act from the rule filing requirements of Section 19(b) of the Act for changes to those BX Options rules that are effectuated solely by virtue of a change to a cross-referenced CBOE, NYSE, or FINRA rule.\(^ {142}\) The Exchange proposes to incorporate by reference categories of rules (rather than individual rules within a category) that are not trading rules. The Exchange agrees to provide written notice to Options Participants prior to the launch of BX Options of the specific CBOE, NYSE, and FINRA rules that it will incorporate by reference.\(^ {143}\) In addition, the Exchange will notify Options Participants whenever CBOE, NYSE, or FINRA proposes a change to a cross-referenced CBOE, NYSE, or FINRA rule.\(^ {144}\)

Using its authority under Section 36 of the Act, the Commission previously exempted certain SROs from the requirement to file proposed rule changes under Section 19(b) of the Act.\(^ {145}\) Each such exempt SRO agreed to

\(^{140}\) Specifically, the Exchange proposes to incorporate by reference: (1) CBOE rules governing position and exercise limits for equity and index options, which are cross-referenced in Chapter III, Sections 7 and 9 of the proposed BX Options Rules and Chapter XIV, Sections 5 and 7 of the proposed BX Options Rules, respectively; (2) the margin rules of the CBOE or the NYSE, which are referenced in Chapter XIII, Section 3 of the proposed BX Options Rules; and (3) FINRA’s rules governing communications with the public, which are referenced in Chapter XI, Section 22 of the proposed BX Options Rules.

\(^{141}\) 17 CFR 240.0–12.

\(^{142}\) See Letter from Jeffrey S. Davis, Vice President and Deputy General Counsel, NASDAQ OMX, to Elizabeth M. Murphy, Secretary, Commission, dated June 21, 2012.

\(^{143}\) See id.

\(^{144}\) The Exchange will provide such notice through a posting on the same Web site location where the Exchange will post its own rule filings pursuant to Rule 19b–4(l) under Act, within the time frame required by that Rule. The Web site posting will include a link to the location on the CBOE, NYSE, or FINRA Web site where those SROs’ proposed rule changes are posted. See id.


\(^{146}\) As discussed above, the Exchange has represented that it will notify Options Participants whenever the CBOE, NYSE, or FINRA proposes a change to a cross-referenced CBOE, NYSE, or FINRA rule. See supra note 144 and accompanying text.


effective, it is further ordered that the operation of BX Options is conditioned upon the satisfaction of the requirements below:

A. Participation in National Market System Plans Relating to Options Trading. BX must join: (1) the OPRA Plan; (2) the OLPP; (3) the Linkage Plan; and (4) the Plan of the Options Regulatory Surveillance Authority.

B. RSA and Rule 17d–2 Agreements. BX must ensure that all necessary changes are made to its Regulatory Services Agreement with FINRA and must be a party to the multi-party Rule 17d–2 agreements concerning options sales practice regulation and market surveillance.\(^ {148}\)

C. Participation in the Options Clearing Corporation. BX must join the Options Clearing Corporation.

D. Participation in the Intermarket Surveillance Group. BX must be a member of the Intermarket Surveillance Group.

E. Effective Regulation. BX must have, and represent in a letter to the staff in the Commission’s Office of Compliance Inspections and Examinations that it has, adequate procedures and programs in place to effectively regulate BX Options.

F. Trade Processing and Exchange Systems. The Exchange must have, and represent in a letter to the staff in the Commission’s Division of Trading and Markets that it has, adequate procedures and programs in place, as detailed in Commission Automation Policy Review guidelines, to effectively process trades and maintain the confidentiality, integrity, and availability of the Exchange’s systems.\(^ {149}\)

It is further ordered, pursuant to Section 36 of the Act,\(^ {150}\) that BX shall be exempted from the rule filing requirements of Section 19(b) of the Act with respect to the CBOE, FINRA, and NYSE rules that BX proposes to incorporate by reference, subject to the conditions specified in this Order.

\(^{148}\) See supra notes 117 and 119 and accompanying text. See also 17 CFR 240.17d–2.


SECURITIES AND EXCHANGE COMMISSION


Self-Regulatory Organizations;
Chicago Mercantile Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Adopt Changes That Would Affect Its Standard Portfolio Analysis of Risk Methodology for Certain Energy Futures Contracts


Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 1 and Rule 19b–4 thereunder, 2 notice is hereby given that on June 14, 2012, Chicago Mercantile Exchange, Inc. ("CME") filed with the Securities and Exchange Commission ("Commission") the proposed rule change described in Items I, II and III below, which items have been prepared primarily by CME. CME filed the proposed rule change pursuant to Section 19(b)(3)(A) 3 of the Act and Rule 19b–4(f)(4)(ii) 4 thereunder, so that the proposed rule change was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

CME proposes to adopt certain changes that would affect its Standard Portfolio Analysis of Risk ("SPAN") methodology for certain energy futures contracts. The text of the proposed rule change is available at the CME’s Web site at http://www.cmegroup.com/market-regulation/rule-filings.html.

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

In its filing with the Commission, CME included statements concerning the purpose 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. CME has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements. 5

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

CME proposes to adopt certain changes that would affect its SPAN methodology for certain energy futures contracts. The change would be to adopt the Modified Split Allocation feature of SPAN. The Modified Split Allocation feature calibrates the risk of portfolios, consisting of positions in highly similar and correlated futures and options, including instruments which themselves represent the offset or basis between two sets of products. The feature represents an incremental enhancement to the split allocation methodology already in use to allow for the “splitting” of certain futures contracts into their true underlying components to enable more accurate margining, while maintaining proper assessments of second order volatility risk.

With the Modified Split Allocation feature, futures products, which are made up of components of other futures products will no longer have to be margined separately and managed with inter-commodity credit amounts allowing for more optimal spread offsets. The Modified Split Allocation will allow automatic, consistent and accurate portfolio margining of these types of futures contracts, beginning with the WTI Calendar Swap Futures (CS) and the Brent Calendar Swap Futures (CY).

The text of a CME Clearing Advisory Notice constitutes CME’s proposed change. CME also made a filing, CME Submission 12–189, with the CFTC with respect to the proposed changes. The changes were scheduled to become operational on June 25, 2012.

The proposed CME changes are limited to CME’s activities as a derivatives clearing organization clearing futures transactions. As such, CME believes the proposed CME changes do not significantly affect the security-based swap clearing operations of CME or any related rights or obligations of CME security-based swap clearing participants. CME believes the proposed change is therefore properly filed under Section 19(b)(3)(A) and Rule 19b–4(f)(4)(ii) thereunder because it effects a change in an existing service of a registered clearing agency that primarily affects the futures clearing operations of the clearing agency with respect to futures that are not security futures and does not significantly affect any securities clearing operations of the clearing agency or any related rights or obligations of the clearing agency or persons using such service.

B. Self-Regulatory Organization’s Statement on Burden on Competition

CME does not believe that the proposed rule change will have any impact, or impose any burden, on competition.

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

CME has not solicited, and does not intend to solicit, comments regarding this proposed rule change. CME has not received any unsolicited written comments from interested parties.

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

The foregoing rule change was filed pursuant to Section 19(b)(3)(A) 6 of the Act and Rule 19b–4(f)(4)(ii) 7 thereunder and thus became effective upon filing because it effects a change in an existing service of a registered clearing agency that primarily affects the futures clearing operations of the clearing agency with respect to futures that are not security futures and does not significantly affect any securities clearing operations of the clearing agency or any related rights or obligations of the clearing agency or persons using such service. At any time within sixty days of the filing of such rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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 may be submitted by using the Commission’s

1 17 CFR 200.30(a)(12).