1900 Market Street
Philadelphia, PA 19103

July 1, 2013

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Securities Exchange Act Release No. 69684
File No. SR-BX-2013-016

Dear Ms. Murphy:

On June 3, 2013, the Securities and Exchange Commission ("Commission") issued an Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change to Adopt a Directed Order Process ("Order")[1] with respect to SR-BX-2013-016, a proposal by NASDAQ OMX BX, Inc. ("BX"), to establish a directed order process ("BX Proposal"). BX appreciates the opportunity to comment on the questions raised by the Commission in the Order.

In the Order, the Commission points out that the BX Proposal would not require that a Directed Market Maker be quoting at the National Best Bid/Offer ("NBBO") at the time a Directed Order is received. As stated in our prior response letter, BX does not believe that this aspect of the proposed rule change would impact market makers' incentives to quote competitively on BX.[2] While affording a Directed Allocation at the NBBO only when the Directed Order is received provides an incentive to quote on the NBBO, it does not follow that the BX proposal creates a *disincentive* to quote competitively. Today, market participants with quotes or orders away from the NBBO can obtain priority at that price when that price becomes the NBBO, regardless of whether a directed order is involved. A market maker, for example, can quote away from the NBBO hoping that once the better price(s) is cleared, such market maker can participate at the next price level. If such market maker is the only quote at that next price once the better prices are cleared, the market maker will get the entire remaining portion of the order (directed or not. If there is another quote or order next-in-

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1 Securities Exchange Act Release No. 69684 (June 3, 2013).

2 Letter from Edith Hallahan, Principal Associate General Counsel, The NASDAQ OMX Group, Inc., dated April 17, 2013.

time in a price-time option, such market maker would have priority; that is the essence of price-time priority – to reward the first quote/order, even when that quote/order was not quoting aggressively at the NBBO earlier. BX would also like to point out that when an order is executed at multiple price levels, at no time during that transaction may a Directed Market Maker (or any other participant type for that matter)
"step-up" to participate in that transaction. Thus, BX believes that there would still be an incentive to quote competitively and that market makers who quote after a Directed Order is received[3] are nevertheless providing liquidity to the marketplace.

Indeed, the Order points out the BX argument that availability of quotes beyond the current NBBO is an important aspect of price discovery, particularly with respect to execution of larger orders when the NBBO is for a small size. BX believes that ignoring the benefit of orders that add depth to the market is an overly narrow view of the price discovery process. The benefit of those quotes and orders is that they provide liquidity at multiple price levels. As BX has previously stated, providing depth to the market, whether through orders or quotes, is vital. The price discovery process is, in fact, *improved* by deep markets and does not require or anticipate that every market maker should quote on the NBBO at all times.

In its second comment letter, NYSE Euronext (on behalf of NYSE Arca Inc. and NYSE Amex Options LLC) argues that, because of the lack of an NBBO quoting requirement, "BX Market Makers will be able to lay in wait outside the NBBO, allowing other participants to participate in the order at less attractive prices and then receiving a 40% guarantee for that portion of the Directed Order that trades at more attractive prices (from the Market Maker's standpoint) beyond the initial NBBO," and this will destroy incentives for Market Makers to quote aggressively at the NBBO.[4] To reiterate, the BX Proposal *does* include a requirement to quote at the NBBO in order to receive a Directed Allocation. Directed Orders will not execute against Directed Market Makers except at the current NBBO. A "lay in wait" strategy places a market maker at risk of not participating in executions at all, particularly respecting smaller orders. The intense competition at the NBBO, both on BX as well as other options exchanges, would limit the effectiveness of this strategy.

3 BX notes that Directed Market Makers will not know that an order is a Directed Order before it is executed, and, therefore, will not be able to adjust their quotes based on the status of the order.

4 Letter from Janet McGinness, Corporate Secretary, NYSE Euronext, dated May 10, 2013.

Under the BX proposal, a Directed Market Maker to whom an order is directed in an option subject to price/time priority would receive a 40% allocation ahead of orders of other market participants, including customer orders that had time priority over the Directed Market Maker's quotation. The Exchange does not believe that this aspect of the proposed rule change is inconsistent with the Securities Exchange Act of 1934 ("Act"). Customer priority is not mandated by the Act or the rules and regulations thereunder. Moreover, the price-time models of various exchanges do not afford customer priority today. NYSE stated in its second comment letter that permitting Directed Allocations to a Directed Market Maker ahead of a customer order is some sort of "failure" to respect public customers and the longstanding distinction between a public customer and a professional.[5] However, that distinction was rooted in floor-based models with customers not paying fees - models that are no longer ubiquitous in the options market. This distinction also developed in a pro rata priority model to address the potential for professionals to "size out" public customers, which highlighted the need for public customer priority. In light of that history, the BX Proposal maintains public customer priority where the pro rata priority algorithm applies. The price/time model does not raise that same issue and thus BX has chosen not to afford customer priority in its price/time model for Directed Orders.

BX believes that although the proposal may impact customers, it is not inconsistent with the protection of investors. It is important to recognize that Directed Orders have the potential to benefit all participants on a particular market, because, as the BX Proposal pointed out, but for the Directed Order coming to BX, the public customer may never have been executed on BX. Consider the following example:

BX Options:
Firm1 Public Customer Order A Sell at $1.05 for 100
MM1 Quote A to $1.00 x $1.05 (size 100 x 100)
BX market: $1.00 x $1.05 (size 100 x 200)

NOM: $1.00 X $1.05(size 100 x 100 on the NBBO)

Order B to buy 100 is sent to NOM (rather than BX Options)

Order B is executed 100 at $1.05

Public Customer Order A on BX Options gets zero

This example illustrates that, today, the BX order could remain unfilled if the directed order is not sent to BX. BX is trying to compete for order flow by offering this program to attract orders to BX Options. BX believes that this

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[5] Id.

proposal will attract liquidity-removing orders, which will, in turn, benefit all market participants. Robust competition among the options exchanges will dictate where market participants send their orders. If BX is mistaken about the attractiveness of this proposal, those orders will simply migrate, through normal competitive processes, to one of the other options exchanges.

NYSE notes that, under the BX's proposal, a Directed Market Maker would receive a Directed Allocation regardless of whether there was an earlier-arriving Public Customer order. NYSE further argues that this provision would reduce the incentives of public customers to improve the NBBO, resulting in fewer displayed public customer orders and fewer public customers willing to improve the NBBO. BX disagrees. Public customers who improve the NBBO still get rewarded under BX's Proposal, possibly to a lesser degree. The Directed Allocation rewards the Directed Market Maker who attracted the Directed Order while also benefiting the customer by allocating 60% of the order to the customer.

Under the proposed rule change, a Directed Order would remain as such as long as it exists on BX and the Directed Market Maker would be eligible for a Directed Allocation at all price levels at which the Directed Market Maker has a quote or order. BX does not believe that this aspect of the proposed rule change would have an impact on quote competition on the Exchange. To be clear, no executions will occur at a particular price unless all orders at more aggressive prices have first been executed. As explained above, Directed Market Makers would have the incentive to provide their best quote to the market. In addition, such market makers would have the incentive to add depth to the market for an option by providing quotes at multiple price levels. BX believes that liquidity at multiple price levels is an essential component of a healthy market.

The BX Proposal would subject a Directed Market Maker to heightened quoting obligations after receipt of the first Directed Order in a given month, rather than before receiving a Directed Order. BX believes that this is appropriate because a Directed Market Maker does not necessarily know when and if such Market Maker will receive a Directed Order. BX believes that this provision properly balances the benefits of receiving enhanced allocations with heightened quoting obligations, consistent with the Act. Specifically, BX believes that the heightened quoting obligation is a rigorous requirement and is not necessary to apply until the Directed Order arrangement is actually functioning in terms of the Directed Participant sending Directed Orders. If the Directed Market Maker is not quoting, the Directed Order will not execute against such Directed Market Maker, which is why the Directed Market Maker has the incentive to quote competitively and in as many series as possible to attract Directed Orders.

BX continues to believe that its filing satisfies the requirements of Section 6(b)(5) of the Act, because it will establish a directed order process that will provide participants with additional choices among the many competing exchanges with regard to their execution needs and strategies. Accordingly, BX believes that the Commission should approve the proposal.

If you have any questions, please contact me at (215) 496-5179.

Sincerely,

Edith Hallahan
Principal Associate
General Counsel