

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59647; File No. 4-546)

March 30, 2009

Joint Industry Plan; Chicago Board Options Exchange, Incorporated, International Securities Exchange, LLC, The NASDAQ Stock Market LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NYSE Amex LLC, and NYSE Arca, Inc.; Notice of Filing of Proposed Options Order Protection and Locked/Crossed Market Plan

I. Introduction

On September 13, 2007, and September 18, 2007, pursuant to Rule 608 of Regulation NMS under the Securities Exchange Act of 1934 (“Act”) (“Rule 608”),¹ the International Securities Exchange, LLC (“ISE”) and NYSE Arca, Inc. (“NYSE Arca”), respectively, filed with the Securities and Exchange Commission (“Commission”) the proposed Options Order Protection and Locked/Crossed Market Plan.² On December 11, 2007, ISE and NYSE Arca separately filed Amendment No. 1 to the Proposed Plan.³ On April 24, 2008, and April 17, 2008, ISE and NYSE Arca, respectively, filed Amendment No. 2 to the Proposed Plan.⁴ On November 10, 2008 and October 31, 2008, ISE and NYSE Arca, respectively, filed Amendment

¹ 17 CFR 242.608.

² See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated September 12, 2007 (“ISE Letter 1”); and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated September 14, 2007 (“NYSE Arca Letter 1”). The proposed Options Order Protection and Locked/Crossed Market Plan, as amended, is defined herein as the “Proposed Plan.”

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

⁴ Amendment No. 2 superseded Amendment No. 1 and replaced it in its entirety. See letter from Michael J. Simon, General Counsel, ISE, to Nancy M. Morris, Secretary, Commission, dated April 16, 2008; and letter from Peter G. Armstrong, Managing Director, Options, NYSE Arca, to Nancy M. Morris, Secretary, Commission, dated April 16, 2008.

No. 3 to the Proposed Plan.⁵ On April 30, 2008, May 8, 2008, June 18, 2008, June 18, 2008, and July 9, 2008, respectively, Chicago Board Options Exchange, Incorporated (“CBOE”), The NASDAQ Stock Market LLC (“Nasdaq”), American Stock Exchange LLC (“Amex”) (f/k/a NYSE Alternext US LLC, “NYSE Alternext,” n/k/a NYSE Amex LLC, “NYSE Amex”), Philadelphia Stock Exchange, Incorporated (n/k/a NASDAQ OMX PHLX, Inc., “Phlx”), and Boston Stock Exchange, Inc. (“BSE”) (n/k/a NASDAQ OMX BX, Inc., “BX” and together with ISE, NYSE Arca, CBOE, Nasdaq, NYSE Amex, and Phlx, the “Proposing Exchanges”) filed with the Commission the Proposed Plan.⁶ On November 25, 2008, November 26, 2008, December 2, 2008, December 4, 2008, and December 5, 2008, CBOE, NYSE Alternext, BSE, Phlx, and Nasdaq, respectively, filed Amendment No. 1 to the Proposed Plan.⁷ Pursuant to Rule 608, the Commission is publishing this notice of, and soliciting comments on, the Proposed Plan.

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

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

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

II. Background

Currently, the Proposing Exchanges are signatories to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage (“Current Plan”).⁸

The Current Plan is a national market system plan linking its participants. In adopting the Securities Acts Amendments of 1975, Congress stated its finding that “linking of all markets for qualified securities through communication and data processing facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors’ orders, and contribute to best execution of such orders.”⁹ Consequently, Congress directed the Commission to oversee the development of a national market system. One of the principal purposes of the national market system is to assure “the practicability of brokers executing investors’ orders in the best market.”¹⁰

Prior to 1999, options were primarily traded on a single exchange. However, as the options exchanges increasingly began multiply listing and trading options classes previously listed on a single exchange, the need for measures to ensure that customer orders are executed in the best market became necessary.¹¹ For this reason, on October 19, 1999, the Commission

Acting Secretary, Commission, dated December 1, 2008 (“BSE Letter 2”); Richard S. Rudolph, Vice President and Counsel, Phlx, to Florence Harmon, Acting Secretary, Commission, dated December 3, 2008 (“Phlx Letter 2”); and Jeffrey S. Davis, Vice President and Deputy General Counsel, The NASDAQ OMX Group, Inc., to Florence Harmon, Acting Secretary, Commission, dated December 4, 2008 (“Nasdaq Letter 2”).

⁸ On July 28, 2000, the Commission approved the Current Plan which was proposed by Amex, CBOE, and ISE. See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000).

⁹ Section 11A(a)(1)(D) of the Act.

¹⁰ 15 U.S.C. 78k-1(a)(1)(C)(iv).

¹¹ See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023, 48024 (August 4, 2000).

ordered the options markets to submit a linkage plan within 90 days that, at a minimum, included uniform trade-through rules and expanded firm quote obligations to cover agency orders presented by competing exchanges.¹² In response, Amex, CBOE, and ISE submitted the Current Plan, and Pacific Exchange, Inc. (“PCX,” n/k/a NYSE Arca) and Phlx each filed separate plans. The Commission published these plans for comment in the Federal Register and ultimately approved the Current Plan on July 28, 2000.¹³ Subsequently, both PCX and Phlx submitted proposed amendments to the Current Plan to become participants to the Current Plan. Both of these proposed amendments were approved on November 16, 2000.¹⁴ On February 5, 2004, BSE’s proposed amendment to become a participant to the Current Plan became effective.¹⁵ Further, Nasdaq’s proposed amendment to become a participant to the Current Plan became effective on March 21, 2008.¹⁶

The Current Plan requires its participants to avoid, absent reasonable justification and during normal market conditions, trading at a price inferior to that displayed on another market (“trade-through”).¹⁷ The Current Plan provides for several exceptions to trade-through liability,

¹² See Securities Exchange Act Release No. 42029 (October 19, 1999), 64 FR 57674, 57675-76 (October 26, 1999).

¹³ See supra note 8. The plans filed by PCX and Phlx could not be approved as national market system plans, pursuant to Rule 11Aa3-2 (n/k/a Rule 608) under the Act, because neither was filed by two or more sponsors, as required by the rule. 17 CFR 240.11Aa3-2 (n/k/a 17 CFR 242.608).

¹⁴ See Securities Exchange Act Release Nos. 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000) and 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000).

¹⁵ See Securities Exchange Act Release No. 49198 (February 5, 2004), 69 FR 7029 (February 12, 2004).

¹⁶ See Securities Exchange Act Release No. 57545 (March 21, 2008), 73 FR 16394 (March 27, 2008).

¹⁷ Section 8(c) of the Current Plan.

including, among other things, systems malfunction, failure of the receiving market to respond to an incoming order within 30 seconds, failure of the market traded through to complain within the specified time period, complex trades, trading rotations, and non-firm quotations on the market that was traded through.¹⁸ The Current Plan also provides a mechanism by which a member of a participating exchange could seek satisfaction if a customer order is traded through.¹⁹

In addition, under the Current Plan, its participants agree that the dissemination of “locked” or “crossed” markets should be avoided, and, if their members lock or cross a market, they should take remedial actions to unlock or uncross such market.²⁰ Further, the Current Plan contains provisions to address trade comparison, clearing, trading halts, non-firm quotations, and administration of the Current Plan.²¹ Except with respect to the addition of new participants and the withdrawal of current participants, any proposed change to the Current Plan must be approved unanimously by its participants.²²

The participating exchanges comply with the requirements of the Current Plan, including the prohibition against trade-throughs, by utilizing a stand alone system (“Linkage Hub”) to send and receive specific order types. The Linkage Hub is a centralized data communications network that electronically links the options exchanges to one another. The Options Clearing Corporation (“OCC”) operates the Linkage Hub.²³

¹⁸ Section 8(c)(iii) of the Current Plan.

¹⁹ Section 8(c)(ii) of the Current Plan.

²⁰ Section 7(a)(i)(C) of the Current Plan.

²¹ Sections 5, 9, and 10 of the Current Plan.

²² Section 5(c)(i) of the Current Plan.

²³ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

There are three defined order types under the Current Plan that its participants could route through the Linkage Hub to limit trade-throughs: orders represented by eligible market makers on behalf of customers (“Principal Acting as Agent Orders” or “P/A Orders”);²⁴ orders for the principal accounts of market makers and specialists (“Principal Orders”);²⁵ and orders intended to satisfy trade-through liabilities (“Satisfaction Orders”).²⁶ Non-market-maker broker-dealers do not have access to the Linkage Hub.

While acknowledging that the Current Plan largely has worked satisfactorily,²⁷ the Proposing Exchanges seek to withdraw from the Current Plan²⁸ and operate under an alternative linkage plan, the Proposed Plan. The Proposing Exchanges contend that the continuing growth in the volume of options traded since the Commission approved the Current Plan has strained market makers’ ability to comply with the current Linkage Hub rules. They further note that the options markets have been moving towards quoting in pennies, and options quoted in pennies now represent a significant amount of the total industry volume. The Proposing Exchanges

²⁴ Sections 2(16)(a) and 7(a)(ii)(B) of the Current Plan.

²⁵ Sections 2(16)(b) and 8(b)(iii) of the Current Plan.

²⁶ Sections 2(16)(c) and 7(a)(ii)(C) of the Current Plan.

²⁷ See ISE Letter 1 and NYSE Arca Letter 1, supra note 2; see also Amex Letter 1, BSE Letter 1, CBOE Letter 1, Nasdaq Letter 1, and Phlx Letter 1, supra note 6.

²⁸ Section 4(d) of the Current Plan states that a participant could withdraw from the Current Plan by giving notice, filing an amendment to the Current Plan, and paying any accrued costs for which it is responsible. Section 5(c)(iii) of the Current Plan further states that the amendment effecting the withdrawal must specify how such participant “plans to accomplish, by alternate means, the goals of the [Current Plan] regarding limiting Trade-Throughs of prices on other exchanges trading the same options classes.” The Commission notes that, should the Proposing Exchanges choose to withdrawal from the Current Plan, they would be required to meet these requirements.

assert that quoting in pennies increases the number of price changes in an option, which in turn gives rise to a greater chance of missing the market.²⁹

The Proposing Exchanges also state that the operating rules of the Current Plan are complex. They contend that there are restrictions on when market makers could send Principal Orders, and rules on the size of P/A Orders are complicated. Moreover, the Proposing Exchanges represent that, unlike the Current Plan, their proposed alternative linkage would eliminate the need for achieving unanimity to change even the most minor aspect of the linkage mechanism.³⁰

The Proposing Exchanges propose an alternative, rules-based approach to intermarket options linkage. This rules-based approach would require neither a central linkage mechanism, nor a complex set of operating rules.

III. Description of the Proposed Plan

A brief summary of the Proposed Plan is provided below. The full text of the Proposed Plan submitted by the Proposing Exchanges, is available on the Commission's Web site at <http://sec.gov/rules/sro/nms/nmsarchive/nms2007.shtml#4-546>, at the each Proposing Exchange's principal office, and at the Commission's Public Reference Room.

A. Order Protection

1. Prevention of Trade-Throughs

²⁹ See ISE Letter 1 and NYSE Arca Letter 1, supra note 2; see also Amex Letter 1, BSE Letter 1, CBOE Letter 1, Nasdaq Letter 1, and Phlx Letter 1, supra note 6.

³⁰ See infra note 84 and accompanying text.

The Proposed Plan would require each Participant³¹ to establish, maintain, and enforce written policies and procedures as approved by the Commission that are reasonably designed to prevent Trade-Throughs in Eligible Options Classes.³² The Proposed Plan would define an “Eligible Options Class”³³ as all option series overlying a security or group of securities, which class is available for trading on two or more Eligible Exchanges. A “Trade-Through”³⁴ would

³¹ The Proposed Plan defines “Participant” to mean an Eligible Exchange whose participation in the plan has become effective pursuant to Section 3(c) of the Proposed Plan. See Section 2(15) of the Proposed Plan. As with the Current Plan, the Proposed Plan defines “Eligible Exchange” to mean a national securities exchange registered with the Commission in accordance with Section 6(a) of the Act that is a Participant Exchange in OCC (as that term is defined in Section VII of the OCC by-laws) and is a party to the OPRA Plan (as that term is described in Section I of the OPRA Plan). In addition, under the Proposed Plan, if a national securities exchange chooses not to become a party to the Proposed Plan, it would still be included in the definition of “Eligible Exchange” if it is a participant in another plan approved by the Commission providing for comparable Trade-Through and Locked and Crossed Market protection. See Section 2(6) of the Proposed Plan and Section 2(6) of the Current Plan. Thus, the Best Bids and Best Offers on exchanges that remain participants in the Current Plan would be protected against Trade-Throughs by Participants in the Proposed Plan. “OPRA Plan” means the plan filed by the Options Price Reporting Authority with the Commission pursuant to Section 11Aa(1)(C)(iii) of the Act and approved by the Commission and declared effective as of January 22, 1976, as from time to time amended. See Section 2(14) of the Proposed Plan. For the definitions of “Trade-Through,” “Best Bid” or “Best Offer,” “Locked Market,” and “Crossed Market,” see infra notes 34, 36, 78, and 79, respectively, and accompanying texts.

³² Section 5(a)(i) of the Proposed Plan.

³³ Section 2(7) of the Proposed Plan. The Current Plan defines “Eligible Options Class” to mean all option series overlying a security or group of securities, including both put options and call options, which class is traded on two or more participants of the Current Plan. See Section 2(8) of the Current Plan.

³⁴ Section 2(21) of the Proposed Plan. The Current Plan defines “Trade-Through” to mean a transaction in an options series at a price that is inferior to the national best bid and offer in an options series calculated by that plan’s participant, but does not include a transaction that occurs at a price that is one minimum quoting increment inferior to the national best bid and offer provided a linkage order is contemporaneously sent to each of that plan’s participant disseminating the national best bid and offer for the full size of the participant’s bid (offer) that represents the national best bid and offer. See Section 2(29) of the Current Plan.

be defined as a transaction in an option series, either as principal or agent, at a price that is lower than a Protected Bid or higher than a Protected Offer. A “Protected Bid” or a “Protected Offer”³⁵ would mean a bid or offer in an option series that is displayed by an Eligible Exchange, is disseminated pursuant to the OPRA Plan, and is the Best Bid or Best Offer of an Eligible Exchange. A “Best Bid” or “Best Offer”³⁶ would mean the highest bid price or the lowest offer price communicated by a member of an Eligible Exchange to any broker-dealer or to any customer³⁷ at which such member is willing to buy or sell, either as principal or agent. A Best Bid or Best Offer would not include indications of interest.

The Proposed Plan would also require each Participant to agree to conduct surveillance of its market on a regular basis to ascertain the effectiveness of the policies and procedures to prevent Trade-Throughs and to take prompt action to remedy any deficiencies in such policies and procedures.³⁸ In addition, the Commission notes that Rule 608(c) requires that each self-regulatory organization, absent reasonable justification or excuse, enforce compliance with any national market system plan by its members and persons associated with its members.³⁹

2. Exceptions to Trade-Throughs

³⁵ Section 2(17) of the Proposed Plan. Protected Bid and Protected Offer, together are referred to herein as “Protected Quotation.” See Section 2(18) of the Proposed Plan.

³⁶ Sections 2(1) and 2(2) of the Proposed Plan. Under the Current Plan, “best” as used with reference to bids (offers) means the bid (offer) that is highest (lowest). See Section 2(2) of the Current Plan.

³⁷ A “customer” would be defined an individual or organization that is not a broker-dealer. See Section 2(5) of the Proposed Plan.

³⁸ Section 5(a)(ii) of the Proposed Plan. The Current Plan states each of its participants shall establish procedures to conduct surveillance of its market to identify trades executed at prices inferior to the national best bid and offer. See Section 8(c)(i)(B) of the Current Plan.

³⁹ 17 CFR 242.608(c).

The Proposed Plan would provide exceptions for certain transactions from the prohibition against Trade-Throughs. The Proposed Plan would also provide that, if a Participant relies on an exception, it would be required to establish, maintain, and enforce written policies and procedures reasonably designed to assure compliance with the terms of the exception.⁴⁰ Below is a discussion of the proposed exceptions.

System Issues:⁴¹ The Proposing Exchanges state that this exception corresponds to the system-failure exception in Regulation NMS for equity securities and would permit a Participant to trade through a Protected Quotation when the Eligible Exchange displaying such Protected Quotation is experiencing system problems.⁴² The Participants would adopt “self-help” rules to implement this exception.⁴³

Trading Rotations:⁴⁴ This exception would permit a Participant to trade through a Protected Quotation disseminated by an Eligible Exchange during a trading rotation. It carries forward a trade-through exception in the Current Plan⁴⁵ and is the options equivalent to the single price opening exception in Regulation NMS for equity securities.⁴⁶ Options exchanges use a trading rotation to open an option for trading or reopen an option after a trading halt. The

⁴⁰ Section 5(a)(i) of the Proposed Plan.

⁴¹ Section 5(b)(1) of the Proposed Plan.

⁴² See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7. See also Rule 611(b)(1) of Regulation NMS under the Act (17 CFR 242.611(b)(1)).

⁴³ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7. Such proposed rules would be subject to notice, comment, and Commission review pursuant to Section 19(b) of the Act.

⁴⁴ Section 5(b)(ii) of the Proposed Plan.

⁴⁵ Section 8(c)(iii)(E) of the Current Plan.

⁴⁶ See Rule 611(b)(3) of Regulations NMS under the Act (17 CFR 242.611(b)(3)).

rotation is effectively a single price auction to price the option,⁴⁷ and there are no practical means to include prices on other exchanges in that auction.⁴⁸

Crossed Markets:⁴⁹ This exception would permit a Participant to trade through when markets are crossed and is identical to the crossed quote exception in Regulation NMS.⁵⁰ A Crossed Market is when a Protected Bid is higher than a Protected Offer. The Proposing Exchanges state that permitting transactions to be executed without regard to Trade-Throughs in a Crossed Market would allow the market quickly return to equilibrium.⁵¹

Intermarket Sweep Orders:⁵² The Proposed Plan includes two exceptions from the prohibition against Trade-Throughs for certain transactions involving Intermarket Sweep Orders⁵³ (or “ISOs”). An ISO would be defined as a limit order for an options series that, when routed to an Eligible Exchange, is identified as an Intermarket Sweep Order and, simultaneously with the routing of the order, one or more additional orders, as necessary, are routed to execute against the full displayed size of any Protected Bid, in the case of a limit order to sell, or any

⁴⁷ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁴⁸ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁴⁹ Section 5(b)(iii) of the Proposed Plan. For the definition of a “Crossed Market,” see infra note 79 and accompanying text.

⁵⁰ See Rule 611(b)(4) of Regulation NMS under the Act (17 CFR 242.611(b)(4)).

⁵¹ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁵² Section 5(b)(iv) and (v) of the Proposed Plan.

⁵³ Section 2(9) of the Proposed Plan. Moreover, the Proposed Plan would provide that each Participant would be required to take reasonable steps to establish that ISOs meet the requirements of the Proposed Plan. See Section 5(c) of the Proposed Plan.

Protected Offer, in the case of a limit order to buy, for the options series with a price that is superior to the limit price of the order. Such additional orders would also be marked as ISOs.⁵⁴

The Proposed Plan would permit a Participant to execute orders marked as ISOs even when the Participant is not at the national best bid or offer (“NBBO”). A Participant would also be permitted to execute an order when it is not at the NBBO, provided the Participant simultaneously “sweeps” all Protected Quotations using an ISO.⁵⁵ The Proposing Exchanges state that these exceptions correspond to the ISO exceptions in Regulation NMS.⁵⁶

Quote Flickering:⁵⁷ This exception would permit a Participant to trade through a Protected Quotation on an Eligible Exchange if within one second prior to the execution, such Eligible Exchange had displayed a price equal or inferior to the price of the transaction. The Proposing Exchanges state that this exception corresponds to the flickering quote exception in Regulation NMS.⁵⁸ The Proposing Exchanges state that options quotations change as rapidly, if not more rapidly, than cash-equity quotations. Options quotations track the price of the underlying instrument or index and thus generally change when the price of the underlying changes. This exception would provide a form of “safe harbor” to Participants to allow them to

⁵⁴ A Participant could place any unexecuted, and uncanceled, portion of an ISO on its book.

⁵⁵ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁵⁶ Id. See also Rule 611(b)(5) and (6) of Regulation NMS under the Act (17 CFR 242.611(b)(5) and (6)).

⁵⁷ Section 5(b)(vi) of the Proposed Plan.

⁵⁸ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7. See also Rule 611(b)(8) of Regulation NMS under the Act (17 CFR 242.611(b)(8)).

trade through prices that have changed within a second of the transaction causing a nominal Trade-Through.⁵⁹

Non-Firm Quotes:⁶⁰ This exception carries forward the current non-firm quote Trade-Through exception in the Current Plan⁶¹ and would permit a Participant to trade through a Protected Quotation that was “Non-Firm.”⁶² The Proposing Exchanges state that an Eligible Exchange’s quotations may not be firm for automatic execution during this trading state and thus should not be protected from Trade-Throughs, and, in effect, these quotations are akin to “manual quotations” under Regulation NMS.⁶³

Complex Trades:⁶⁴ This exception carries forward the complex trade exception in the Current Plan⁶⁵ and would permit a Participant to trade through a Protected Quotation if the transaction was part of a “complex trade.” The definition of “complex trade” would be implemented through rules adopted by the Participants, which would be subject to notice, comment, and Commission review pursuant to the Section 19(b) rule filing process. The

⁵⁹ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁶⁰ Section 5(b)(vii) of the Proposed Plan.

⁶¹ Section 8(c)(iii)(C) of the Current Plan.

⁶² “Non-Firm” would be defined to mean, with respect to Quotations in an Eligible Options Class, that members of a Participant are relieved of their obligations under that Participant’s firm quote rule in that Eligible Options Class. See Section 2(11) of the Proposed Plan. The Commission notes that, when quotations in an Eligible Options Class are non-firm, exchange rules require the exchange to provide notice that its quotations are non-firm by appending an indicator to its quotations. See, e.g., CBOE Rule 43.14(b) and NYSE Arca Rule 6.86(d)(1)(C).

⁶³ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁶⁴ Section 5(b)(viii) of the Proposed Plan.

⁶⁵ Section 8(c)(iii)(G) of the Current Plan.

Proposing Exchanges state that because complex trades are composed of multiple transactions (“legs”) effected at a net price, it is not practical to price each leg at a price that does not constitute a Trade-Through. Narrowly-crafted implementing rules should ensure that this exception does not undercut Trade-Through protections.⁶⁶

Customer Stopped Orders:⁶⁷ This exception would permit a Participant to trade through a Protected Quotation if the trade executed a “stopped order.” The exception would require that the “stopped order” be for the account of a Customer; that the Customer agreed to the specified price on an order-by-order basis; and that the price of the Trade-Through was, for a stopped buy order, lower than the national Best Bid in the options series at the time of execution, or, for a stopped sell order, higher than the national Best Offer in the options series at the time of execution. The Proposing Exchanges⁶⁸ state that this exception corresponds to the customer stopped order exception in Regulation NMS.⁶⁹ The Proposing Exchanges state that this exception would permit broker-dealers to execute large Customer orders over time at a price agreed upon by a customer, even though the price of the option may change before the order is executed in its entirety.⁷⁰

⁶⁶ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁶⁷ Section 5(b)(ix) of the Proposed Plan.

⁶⁸ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁶⁹ See Rule 611(b)(9) of Regulation NMS under the Act (17 CFR 242.611(b)(9)).

⁷⁰ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7. For a further discussion on how this exemption operates, see the Regulation NMS Adopting Release, Securities Exchange Act Release No. 51808, June 9, 2005 at notes 322-325.

Stopped Orders and Price Improvement:⁷¹ This exception would permit a Participant to trade through a Protected Quotation if the trade executes an order that is stopped at a price that did not constitute a Trade-Through at the time of the stop.⁷² The Proposing Exchanges state that this exception would allow a Participant to seek price improvement for an order, even if the market moves in the interim, and the transaction ultimately is effected at a price that would trade through the then currently-displayed market.⁷³

Benchmark Trades:⁷⁴ This exception would permit a Participant to trade through a Protected Quotation if the trade was executed at a price not tied to the price of an option at the time of execution and for which the material terms were not reasonably determinable at the time of the commitment to make the trade. An example would be a volume-weighted average price trade, or “VWAP.” The Proposing Exchanges state that this exception corresponds to a Trade-Through exemption in Regulation NMS.⁷⁵ No Participant currently permits these types of

⁷¹ Section 5(b)(x) of the Proposed Plan.

⁷² The rules of several of the Proposing Exchanges currently contain provisions relating to price improvement mechanisms. See, e.g., ISE’s Price Improvement Mechanism and ISE Rule 723. Under these price improvement mechanisms, certain exchange members are typically given the opportunity to offer price improvement to orders received by the exchange during a specified period of time (“auction”). During this auction period, the NBBO could move from where the NBBO was when the order was received. However, the exchange is not required to execute the order at a price at or better than this new NBBO, but instead must guarantee a price no worse than the NBBO at the time the order was received. Thus, following the auction, an execution could result in a Trade-Through if the NBBO improves from the time the order was received although, had the order been executed at the time of receipt, the execution would not have resulted in a Trade-Through.

⁷³ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁷⁴ Section 5(b)(xi) of the Proposed Plan.

⁷⁵ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7. See also Rule 611(b)(7) of Regulation NMS under the Act (17 CFR 242.611(b)(7)).

options trades, and any transaction-type relying on this exemption would require the Participant to adopt rules, which would be subject to notice, comment, and Commission review pursuant to the Section 19(b) rule filing process.⁷⁶

B. Locked and Crossed Markets

The Proposed Plan would also address Locked and Crossed Markets.⁷⁷ A “Locked Market”⁷⁸ would be defined as a quoted market in which a Protected Bid is equal to a Protected Offer in a series of an Eligible Options Class. A “Crossed Market”⁷⁹ would be defined as a quoted market in which a Protected Bid is higher than a Protected Offer in a series of an Eligible Options Class.

Under the Current Plan, its participants agree that the dissemination of “locked” or “crossed” markets should be avoided. Further, the Current Plan requires its participants to have rules requiring that, if a member of a participating exchange locks or crosses a market, such member must take remedial actions to unlock or uncross such market. In addition, under the Current Plan, eligible market makers may direct a Principal Order through the Linkage to trade against the bid or offer that was locked or crossed.⁸⁰

The Proposed Plan would require each Participant to establish, maintain, and enforce written rules that require their members reasonably to avoid displaying Locked and Crossed

⁷⁶ See ISE Letter 2 and NYSE Arca Letter 2, supra note 5; see also Amex Letter 2, BSE Letter 2, CBOE Letter 2, Nasdaq Letter 2, and Phlx Letter 2, supra note 7.

⁷⁷ Section 6 of the Proposed Plan.

⁷⁸ Section 2(10) of the Proposed Plan.

⁷⁹ Section 2(4) of the Proposed Plan.

⁸⁰ Section 7(a)(i)(C) of the Current Plan.

Markets.⁸¹ Participants would also be required to establish, maintain, and enforce written rules reasonably designed to assure the reconciliation of Locked and Crossed Markets.⁸² Finally, the Proposed Plan would provide that Participants must establish, maintain, and enforce written rules that prohibit its members from engaging in a pattern or practice of displaying Locked and Crossed Markets, subject to exceptions as may be contained in the rules of a Participant, as approved by the Commission.⁸³

C. Compliance with the Proposed Plan

1. Amendments to the Proposed Plan

Any proposed change in, addition to, or deletion from the Proposed Plan could be effected only by means of a written amendment to the Proposed Plan that is unanimously approved and executed by the Participants.⁸⁴ Any amendment would need to set forth the change, addition, or deletion and would not become effective until approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder.⁸⁵

2. Joining the Proposed Plan

⁸¹ Section 6(a) of the Proposed Plan. All such rules would be subject to notice, comment, and Commission review pursuant to Section 19(b) of the Act.

⁸² Section 6(b) of the Proposed Plan.

⁸³ Section 6(c) of the Proposed Plan.

⁸⁴ The Commission notes that the Proposing Exchanges believe that the Proposed Plan would eliminate the need for achieving unanimity to change even the most minor aspect of the linkage mechanism. See supra note 30 and accompanying text. Although, as with the Current Plan, any change to the Proposed Plan requires the unanimous approval by its Participants, unlike the Current Plan, the Proposed Plan does not prescribe order types or a method of routing such order types through a centralized linkage mechanism to prevent Trade-Throughs. See supra notes 23-26 and accompanying text. Thus, for example, a Participant in the Proposed Plan would not need to seek the approval of any other Participant to modify the method by which it routes orders to other Participants to comply with the requirements of the Proposed Plan.

⁸⁵ Section 4(a) of the Proposed Plan.

Any national securities exchange would be eligible to become a Participant by executing a copy of the Proposed Plan and providing each Participant with a copy of such executed Proposed Plan⁸⁶ if it is: (1) registered with the Commission in accordance with Section 6(a) of the Act; (2) a Participant Exchange⁸⁷ in OCC; and (3) a party to the OPRA Plan.⁸⁸ Further, any such national securities exchange wishing to become a Participant would be required to file an amendment to the Proposed Plan by executing a copy of the Proposed Plan and submitting such executed Proposed Plan to the Commission.⁸⁹ Such amendment would be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder.⁹⁰

3. Withdrawal from the Proposed Plan

⁸⁶ Section 3(c) of the Proposed Plan. The Commission notes that Section 3(c) of the Proposed Plan actually states that an “Eligible Exchange” may become a Participant by executing a copy of the Proposed Plan and providing each Participant with a copy of the same. The definition of an “Eligible Exchange” includes the conditions listed above and also the condition that, if a national securities exchange who chooses not to become a party to the Proposed Plan, such exchange is a participant in another plan approved by the Commission providing for comparable Trade-Through and Locked and Crossed Market protection. See infra note 31. As this portion of the Eligible Exchange definition is not applicable to the instance of an exchange joining the Proposed Plan as a new Participant, it is not included in the discussion above.

⁸⁷ For a definition of a “Participant Exchange,” see Section VII of the OCC by-laws.

⁸⁸ For more information on who is a party to the OPRA Plan, see Section I of the OPRA Plan.

⁸⁹ Section 4(b) of the Proposed Plan.

⁹⁰ Id. These requirements are identical to those contained in the Current Plan. See Sections 4(c)(i) and 5(c) of the Current Plan. The Current Plan also requires that an eligible exchange pay a fee to join the Current Plan. See Section 4(c)(i)(iv) of the Current Plan. The Proposed Plan does not require an Eligible Exchange to pay a fee to join the Proposed Plan.

Any Participant may withdraw from the Proposed Plan at any time by providing not less than 30 days' prior written notice to each of the other Participants of such intent to withdraw.⁹¹ To withdraw, such Participant also would be required to effect an amendment to the Proposed Plan by submitting such amended Proposed Plan to the Commission for approval.⁹² In submitting the amended Proposed Plan to the Commission, the Participant proposing to withdraw from the Proposed Plan would be required to state how the Participant plans to accomplish, by alternate means, the goal of the Proposed Plan regarding limiting Trade-Throughs of prices on other exchanges trading the same options classes.⁹³ Such withdrawal from the Proposed Plan would be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder. Upon the effectiveness of such withdrawal, the withdrawing Participant would have no further rights or obligations under the Proposed Plan.

D. Implementation

As noted above,⁹⁴ the Proposed Plan would permit a member of a Participant to trade at a price inferior to another market's disseminated quotation if the member sends an Intermarket Sweep Orders to such market for the full size of the disseminated quotation. Thus, unless each Eligible Exchange can accept and execute Intermarket Sweep Orders, a trade-through could occur because the Eligible Exchange would not have the ability to fill the better priced order. Therefore, unless the Commission otherwise authorizes, the Proposed Plan may not be

⁹¹ Section 3(d) of the Proposed Plan.

⁹² Section 4(c) of the Proposed Plan.

⁹³ Id. These requirements are identical to those contained in the Current Plan. See Sections 4(d) and 5(c)(iii) of the Current Plan.

⁹⁴ See supra notes 52-56 and accompanying text.

implemented unless all Eligible Exchanges either (1) have become parties to the Proposed Plan and the Commission has approved all necessary implementing rules⁹⁵ or (2) have developed the ability to accept and execute incoming ISOs. If either of these conditions has been met, the Proposed Plan would be implemented on a date upon which all Participants agree, but not later than February 27, 2009.⁹⁶

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the Proposed Plan is consistent with the Act. The Commission generally invites comments on all aspects of the Proposed Plan, including whether the foregoing assures fair competition. In addition, the Commission seeks comment on the following issues:

1. The Commission requests comment on the relative merits of the Proposed Plan in comparison to the Current Plan. Should the Commission approve the Proposed Plan and permit exchanges to withdraw from the Current Plan? For example, have options volumes increased since the Commission's approval of the Current Plan such that that the option markets are constrained in their ability to comply with the current Linkage Hub rules, as the Proposing Exchanges contend? If so, is the Proposed Plan an appropriate alternative to the Current Plan? Further, under the Current Plan, does quoting in pennies give rise to a greater chance of missing the market by increasing the number of price changes in an option, as the Proposing Exchanges contend? If so, is the Proposed Plan more appropriate means to address this concern?

⁹⁵ Section 7 of the Proposed Plan. As noted above, consideration of the exchanges' proposed rules to implement the Proposed Plan would be pursuant to Section 19(b) of the Act. See supra notes 43 and 81 and accompanying text.

⁹⁶ Section 7 of the Proposed Plan.

2. Is the Proposed Plan's model for addressing Trade-Throughs and Locked and Crossed Markets, which is similar to that used in the equities markets, appropriate for use in the options markets? If not, please specify the aspects of the Proposed Plan that should be modified, how they should be modified, and why. Beyond modifications to the Proposed Plan, please specify if there any aspects of the Proposed Plan that should be eliminated and why.
3. The Commission requests comment as to whether, and if so, to what extent, the Proposed Plan's order protection provisions would have the desired effect of limiting Trade-Throughs.
4. Is the proposed requirement that each Participant establish, maintain, and enforce policies and procedures that are reasonably designed to prevent Trade-Throughs sufficient to protect investors who would no longer have an avenue under the Proposed Plan to obtain satisfaction when an order has been traded through and no exception applies? Are there any consequences for investors and other market participants if satisfaction for Trade-Throughs is no longer is available under the Proposed Plan? How often is satisfaction requested following a Trade-Through? How often are requests for satisfaction filled?
5. Commenters are also asked to comment on the proposed exceptions to the general Trade-Through prohibitions and whether these exceptions would permit adequate protection of customer orders. Are there proposed exceptions that should not be included or that should be adjusted in the Proposed Plan? Should the Commission consider adding additional exceptions? If so, what are they?
6. The Commission requests comment regarding the proposed use of Intermarket Sweep Orders in the options market. What types of identifiers should be required to help ensure

Participants know that they are receiving an Intermarket Sweep Order so that the receiving Participant would be able to execute the order without regard to whether a better price was displayed on another market center?

7. The Proposed Plan would require each Participant to take reasonable steps to establish that Intermarket Sweep Orders meet the requirement of the Proposed Plan. The Commission requests comment on what such reasonable steps should be. For example, because the Proposed Plan would permit members of a Participant to send ISOs, what rules, policies, and procedures should Participants have in place to ensure that such ISOs comply with the requirements of the Proposed Plan?
8. The Commission specifically requests comment on the appropriateness of the proposed Trade-Through exception relating to a systems or equipment failure, material delay, or malfunction. What are the types of situations in which this proposed exception would appropriately apply?
9. Are there any situations for which the exception relating to non-firm quotes would not be sufficient?
10. The proposed definition of “Bid” or “Offer” states that the terms shall mean the bid price or the offer price communicated by a member of an Eligible Exchange to any Broker/Dealer, or to any customer, at which it is willing to buy or sell, as either principal or agent, but shall not include indications of interest. Is this definition sufficiently clear? For example, when would a communication constitute an indication of interest, and thus not be considered a Bid or Offer under the Proposed Plan? Should this concept be defined in the Proposed Plan? If so, how should it be defined?

11. The Commission requests comment on the Proposed Plan's treatment of Locked and Crossed Markets. Are there aspects of the options market that call for different treatment of Locked Market from the equities market? Are there exceptions to Locked Markets that the Commission should consider? What are possible methods the Participants could adopt in their policies and procedures for a member to reconcile or clear Locked and Crossed Markets?
12. Amendments to the Proposed Plan would require the unanimous approval by the Participants. The Commission requests comment on whether a unanimous vote is appropriate.
13. The Commission requests comment on whether the Proposed Plan's February 27, 2009, implementation date is sufficient to allow market participants time to adapt to the new linkage system. If not, what would be an appropriate implementation date?
14. Unless the Commission otherwise authorizes, the Proposed Plan could not be implemented unless all Eligible Exchanges either have become parties to the Proposed Plan or have developed the ability to accept and execute incoming Intermarket Sweep Orders. The Commission requests comment on whether it is appropriate to delay implementation of the Proposed Plan until all Eligible Exchanges have met such requirements. In addition, the Commission requests comment on under what circumstances, if any, it would be appropriate for the Commission to authorize the implementation of the Proposed Plan, despite one or more Eligible Exchanges failing to satisfy such prerequisites.

15. The Commission requests comment, if it were to approve the Proposed Plan, on the nature and length of implementation periods that would be appropriate to allow market participants to prepare for the new linkage system in an efficient and orderly manner.
16. The proposed definition for “Eligible Options Class” is “all options series overlying a security (as that term is defined in Section 3(a)(10) of the Exchange Act) or group of securities, including both put options and call options, which class is available for trading on two or more Eligible Exchanges.” Is this definition sufficient for the Proposed Plan? Is it too narrowly drafted? For example, should the definition include Foreign Currency Options, which are not currently covered by the proposed definition? Are there other products that are, or might be, multiply traded that should be included in the definition of Eligible Options Class?
17. As in Rule 611(a)(1) of Regulations NMS, Section 5(a)(i) of the Proposed Plan provides, in pertinent part, that each Participant agrees to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs. Unlike Regulation NMS, however, the Proposed Plan requires that such policies and procedures be approved by the Commission. In addition, the Current Plan does not require the trade-through surveillance procedures of its Participants to be approved by the Commission.⁹⁷ While national securities exchanges must file proposed rule changes pursuant to Section 19(b) of the Act and the rules thereunder, the Commission notes that it generally does not approve, pursuant to Section 19(b), policies and procedures, though they may be reviewed by the Commission, for example, pursuant to inspections and examinations. The Commission requests comment on whether the Proposed Plan should require that

⁹⁷ See Section 8(c)(i)(B) of the Current Plan.

such policies and procedures be approved by the Commission, or whether such a requirement should be deleted.

18. The Proposed Plan requires participants to establish, maintain, and enforce policies and procedures that are reasonably designed to prevent Trade-Throughs in Eligible Options Classes. The Commission requests comment on the impact that fees charged by exchanges to trade with their best displayed prices would have on the ability of participants to comply with this requirement under the Proposed Plan. Should there be a maximum amount that an exchange is permitted to charge for trading with its displayed prices? If so, what should this maximum amount be?

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-546 on the subject line.

Paper comments:

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

All submissions should refer to File Number 4-546. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's 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 inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the respective principal office of BX, CBOE, ISE, Nasdaq, Phlx, NYSE Amex, and NYSE Arca. 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 4-546 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Elizabeth M. Murphy
Secretary