

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54779; File No. SR-BSE-2006-48)

November 17, 2006

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing of
Proposed Rule Change to Implement a Quote Mitigation Plan

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 November 15, 2006, the Boston Stock Exchange, Inc. (“BSE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the BSE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend the Boston Options Exchange (“BOX”) Rules to add a Quote Mitigation Plan. The text of the proposed rule change is available on the BSE’s Web site at <http://www.bostonstock.com>, at the BSE’s Office of the Secretary, and at the Commission’s Public Reference Room.

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

In its filing with the Commission, the BSE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

Background and Introduction

The U.S. options industry has witnessed an explosion in market broadcast data traffic over the past six years due to a number of factors, including, but not limited to:

- Automation of the quote updating mechanisms used by market makers and specialists;
- Two additional, fully automated exchanges;
- Opening of access to market making status at several exchanges, resulting in multiple “quote streamers” versus the previous environment where essentially only one market maker, the “specialist”, was able to electronically stream quote updates into the exchange trading systems; and
- Proliferation of additional options instruments due to additional options classes and narrower intervals between strike prices (“dollar pilot”).

While the trends which have caused the dramatic increase in options market data traffic have been to the benefit of the investor in terms of improved market quality due to increased competition on the liquidity provider side of the market, they are not without costs. Specifically, according to the Exchange, the Order Flow Providers (“OFPs”) and market data vendors find it increasingly difficult to provide real-time and accurate market data to investors without contemplating significant increases in the costs to the end users

(either in the form of higher rates in the case of the data vendors or higher commissions in the case of the OFPs). It is common belief that this trend will be exacerbated by the implementation of the “penny pilot program” in January 2007.

Many observers feel that a point of diminishing returns has been reached where the marginal extra cost of yet more traffic is not justified in terms of improved market quality or information to the investor. Allowing for different levels of service whereby the end user would pay for the level of market data he wished to receive (e.g. a user wanting real-time, across the board data would pay more than a user who only required market data refreshing at say half-second intervals) has been rejected by the industry as presenting an “unlevel playing field” which would ultimately be to the detriment of the private investor. Furthermore, there are “firm quote obligations” that each exchange must take into account in any strategy it used to reduce traffic.

Quote Mitigation

The Exchange believes it is possible to significantly reduce overall peak market data traffic with a relatively small impact on the quality of information available to options market users, due to the following:

- **Diminishing Returns of Speed:** “Timeliness” of quote updates does indeed have a point of diminishing returns and it is likely that, so long as all options traders and investors are receiving information at the same rate of “delay” from pure “real time”, they are willing to allow similar information to be “bundled” and broadcast with a reasonable delay. For example, a series with ten market makers, all of whom are at the same price on the bid and the offer, and who, in response to information on the underlying security’s price, wish to update their markets to the

same new prices (an admittedly simplistic assumption) can be managed by simply bundling some of the updates so long as the “slowest” message due to this bundling is no higher than an agreed upon lapse. Using this approach, what would have been ten individual updates may be reduced to one update, a reduction of 90%.

- **All Series are Not of Equal Interest to Investors:** BOX presently lists slightly fewer than 500 options classes represented by 80-85,000 different instruments. Market Makers have an obligation to provide continuous two way markets on virtually all of them, representing a staggering amount of update traffic if markets are turbulent. However, not all of these instruments are of “equal interest” to options investors. Indeed trading volume tends to concentrate on a relatively small percentage of the overall universe of instruments; arguably, investors and traders are quite willing to tolerate reasonable update delays in those instruments deemed to be of lesser interest. For example, over 25% of all series cleared by the Options Clearing Corporation (“OCC”) have open interest below 100 contracts, a reasonable indication that the updates concerning over one-quarter of the marketplace are of minimal interest.
- **Certain Updates are More “Interesting” Than Others:** There are three types of updates:
 - a. Those that represent a change in price at the top of the book;
 - b. Those that represent an increase in quantity at the same price at the top of the book; and

c. Those that represent a decrease in quantity at the same price at the top of the book.

Investors are likely in many cases to tolerate delays in b) over delays in c) and consider short delays in a) to be most important of the three.

- **Reducing Traffic “Peaks” Is More Important Than Reducing Overall Quote**

Update Traffic: The costs of Data Vendors and Order Flow firms providing market data services to their customers are more sensitive to the requirements of managing peak³ traffic than they are to processing “normal” traffic. This is true of most technology services since systems generally must be built to manage the “worst”, though they will be, by definition, significantly underutilized over the trading day as a result. In other words, the costs of managing industry traffic will not be significantly reduced if mitigation only reduces overall traffic. Arguably, the biggest “bang for the buck” is in decreasing peak traffic levels. While the bundling algorithm proposed by BOX is likely to be more “efficient” (that is, result in a proportionally greater reduction of traffic) during busier moments like peaks, BOX intends to bundle some of its traffic all of the time, since the open interest threshold will be set no lower than 50 contracts and the bundling lapse at no lower than 200 milliseconds.

³ There are many definitions of “peaks”; it is not necessary to agree on a precise definition here in order to understand the goals. A peak may be defined as either the “N” busiest seconds over the trading session of roughly 23,000 seconds (where “N” is likely equal to 100 or fewer or it may be defined as “those seconds where traffic is “N” times greater than the average over the 23,000 seconds of the trading session and “N” is set to perhaps 3. The point is that the peaks are the exceptional levels that drive the scaling and, therefore, the costs, of the data broadcast systems.

BOX Proposal

BOX believes there are optimal compromises and the accompanying rule proposal for “quote mitigation” addresses this in the following manner:

- Rather than adopt an arbitrary definition of which instruments are considered to be “less interesting,” BOX proposes to “let the market decide” by basing this on the open interest in contracts at the OCC for each instrument. Clearly those series with lower open interest are likely to be of less interest to options traders and investors. The precise threshold of open interest which will determine whether the broadcast of a series is subject to mitigation or not will vary according to the degree BOX is meeting its stated goals of reducing overall traffic. It is anticipated that this threshold could be as high as 300 to 400 contracts, but that it will be no lower than 50 contracts. BOX does not propose to apply mitigation to instruments which have been listed for fewer than ten trading sessions, regardless of the open interest.
- BOX will “bundle” at intervals of up to 1,000 milliseconds (and no less than 200 milliseconds) any changes to its broadcast for those instruments which have fallen below the threshold in the previous point.
- BOX will use variable rates of “bundling” delays for the three different types of broadcast updates: changes in price, increases in quantity without a change in price, and decreases in quantity without a change in price. Under this proposal, changes in prices may be subject to less delay than changes to quantity at same price. For example, BOX may apply a “bundling interval” of 400 milliseconds to updates regarding a price change while using a figure of 1,000 milliseconds for

updates concerning only a change in quantity at the same price. The appropriate mix will be determined by the relative success BOX is meeting in its overall goals of traffic reduction.

The Exchange does not propose to apply the above-described bundling to traffic relating to price improvement auctions or NBBO exposure mechanisms, nor to trade reporting messages. Furthermore, no bundling of quotes is proposed for inbound orders and quotes which are sent to BOX by users; messaging will only be bundled for outbound updates.

The Exchange believes this proposal is an optimal trade-off between costs and benefits and that it is fully compliant with its firm quote obligations. The Exchange further believes that the proposed rule is designed to provide the Exchange with a quote mitigation plan which will significantly reduce overall peak market data traffic with a relatively small impact on the quality of information available to options market users.

- BOX's target reduction in outbound **peak** traffic is 15% to 20% of what the traffic would have been had no mitigation been applied.
- Reduction in **overall** traffic, as opposed to peaks, will be lower, but still significant, with a target of 8% to 10%.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,⁴ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁵ in particular, in that the proposed rule change is designed to promote just and equitable

⁴ 15 U.S.C. 78f(b).

⁵ 15 U.S.C. 78f(b)(5).

principles of trade, to prevent fraudulent and manipulative acts and practices, 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.

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

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

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

Written comments on the proposed rule change were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic Comments:

- Use the Commission's Internet comment form <http://www.sec.gov/rules/sro.shtml>; or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-BSE-2006-48 on the subject line.

Paper Comments:

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

All submissions should refer to File No. SR-BSE-2006-48. 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 at <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. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available

publicly. All submissions should refer to File No. SR-BSE-2006-48 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Nancy M. Morris
Secretary

⁶ 17 CFR 200.30-3(a)(12).