

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55233; File No. SR-BSE-2006-56)

February 2, 2007

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto to Add to the Boston Options Exchange a New Functionality Called an Automatic Auction Order

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 December 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. On February 1, 2007, BSE filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, 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 new functionality referred to as an Automatic Auction Order (“AAO”) in order to make it easier for non-professional customers to participate in a price improvement auction (“Improvement Auction”). The text of the proposed rule change is available at BSE, the Commission’s Public Reference Room, and http://www.bostonstock.com/legal/pending_rule_filings.html.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, BSE granted the Commission an extension of the time period specified in Section 19(b)(2) of the Act for Commission action.

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 the places specified in Item IV below. The BSE 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

BSE seeks to amend the BOX Rules⁴ to add a new order functionality called an AAO in order to make it easier for all Customers, including non-professional customers, to participate in Improvement Auctions (e.g., the PIP). BOX believes that the AAOs will increase the number of Improvement Orders that are submitted to an Improvement Auction, thereby creating increased competition and overall liquidity while also improving execution prices for trades that are executed on BOX.

This AAO functionality automates a process that is currently available to the non-professional customer via the Customer PIP Order (“CPO”). Currently, however, it is difficult for non-professional customers to participate in Improvement Auctions because of the limited offering of the CPO by Order Flow Providers (“OFPs”). Only a few OFPs have made CPOs available to non-professional customers due, in large part, to the constraints that are generally associated with the software development an OFP is required to undertake in order to handle the processing of the CPO. The AAO provides non-professional customers with the ability to trade

⁴ Capitalized terms not otherwise defined herein shall have the meanings prescribed under the BOX Rules.

on the BOX Book at standard trading increments and also trade in penny increments in an Improvement Auction, should one occur. The AAO, as opposed to a standard Limit Order, allows a Customer to participate in the Improvement Auction without any further instructions from the Customer.

The AAO allows for increased competition in the Improvement Auction and offers greater opportunity for price improvement to occur by providing for additional Improvement Orders capable of improving prices.

Description of AAO Processing

An AAO is a Limit Order that is submitted by the OFP on behalf of a Customer to the BOX Trading Host in one-cent increments only on a class whose minimum trading increment is greater than one cent. The penny incremented limit price that is entered by the Customer is referred to as the “AAO Maximum Improvement Price.” The AAO Maximum Improvement Price is the maximum (if the order is to buy) or minimum (if the order is to sell) price at which the Customer is willing to trade in any Improvement Auctions.

AAO Limit Order

The Trading Host will round AAOs to the nearest minimum trading increment⁵ (up if the order is to sell and down if the order is to buy) and place it on the BOX Book (“AAO Limit Order”). The AAO Limit Order will be processed as a standard Limit Order as described in Chapter 5, Section 14(c)(i) of the BOX Rules and will be traded in accordance with Chapter 5, Section 16 of the BOX Rules.

⁵ As delineated in Chapter V, Section 6 of the BOX Rules.

AAO Improvement Order

An AAO will be eligible to participate (subject to Chapter V, Section 18 of the BOX Rules) in any Improvement Auctions that may occur when the AAO is on the opposite side of the market from the order seeking improvement and the AAO Limit Price is equal to the National Best Bid or Offer (“NBBO”). When this situation occurs, the BOX trading engine will automatically create a new order (the “AAO Improvement Order”) at the end of the auction phase, but prior to any trade allocations, with the following terms:

- (1) the quantity of the AAO Improvement Order shall be the lesser of the remaining quantity on the BOX Book at the AAO Limit Price or the quantity of the order seeking improvement in the auction; and
- (2) the price of the AAO Improvement Order shall be equal to the price of the best Improvement Order, Primary Improvement Order or unrelated order (on the same side of the market as the AAO).

Trade Processing of AAO

During an Improvement Auction, if the number of contracts executed in the Improvement Auction against the AAO Improvement Order is less than the quantity of AAO Limit Order, then, prior to the processing of any other orders on the same series on the AAO Limit Order side of the market, the quantity of the AAO Limit Order will be decremented on the BOX Book by the size of the executed quantity of the AAO Improvement Order. Any residual quantity that remains after part of an AAO has traded (either on the BOX Book or in the Improvement Auction) will continue to be eligible to trade in any subsequent Improvement Auctions. In addition, the residual quantity will maintain its priority on the BOX Book in accordance with Chapter V, Section 16 of the BOX Rules.

Any AAO Improvement Order created by the BOX Trading Host will be assigned the time priority of the related AAO Limit Order. As such, the AAO Improvement Order is granted time priority at its relevant price level in an Improvement Auction.

Any modification to the AAO Maximum Improvement Price that causes the rounded AAO Limit Price to change or any increase in the quantity of the AAO will cause a new time priority to be assigned to the AAO Limit Order on the BOX Book. Any changes to the AAO Maximum Improvement Price that do not effect the AAO Limit Price will not cause a change to the time priority of the original order.

Additionally, a new AAO received in a particular series that is on the opposite side of the market from another AAO, which is already on the BOX Book, and is marketable at the AAO Maximum Improvement Price of the other booked AAO (e.g., a buy AAO is on the BOX Book with a Limit Price bid of \$2.00 with an AAO Maximum Improvement Price of \$2.03 and a new sell AAO is received by the BOX Trading Host with an AAO Maximum Improvement Price of \$2.02), will be matched at the mid-point of the two AAO Maximum Improvement Prices, rounded to the nearest penny increment in the favor of the AAO that is already on the BOX Book. The quantity of the resulting trade will be for the lesser quantity of the two AAOs.

Finally, AAOs may be entered for any account type except for the accounts of BOX Market Makers.

The following examples demonstrate how an AAO will work. For all examples, assume an AAO is entered into the Trading Host to buy 100 contracts of XYZ at a Maximum Improvement Price of \$1.03 (referred to in the following examples as the “Original AAO”). The Original AAO will be rounded to \$1.00 (i.e., the nearest minimum trading increment in

accordance with Chapter V, Section 6 of BOX Rules) and the AAO Limit Order placed on the BOX Book at \$1.00.

Example 1

For this example, assume the Original AAO is the only order resting on the BOX Book at \$1.00. An order to sell 70 contracts at market has commenced an Improvement Auction at \$1.01. At the end of the auction, the best Improvement Order is an order to buy 10 contracts of XYZ at \$1.02. The Trading Host creates an AAO Improvement Order for 70 contracts at \$1.02 with the Original AAO Limit Order's time priority which trades against the customer in the Improvement Auction. The remaining 30 contracts from the Original AAO will remain on the BOX Book at their original time priority.

Example 2

In this example, everything is the same as Example 1 except that the market order to sell XYZ is for 100 contracts. The full quantity of the Original AAO (i.e., 100 contracts) will be executed at \$1.02.

Example 3

For this example, assume there is another AAO buy order resting on the BOX Book at \$1.00 that has time priority over the Original AAO (referred to in this example as the "2nd AAO"). The 2nd AAO is for 50 contracts and its AAO Maximum Improvement Price is \$1.04. At the end of an Improvement Auction for 90 contracts to be sold at market, the best Improvement Order is for 10 contracts at \$1.02. Two AAO Improvement Orders are created by the BOX Trading Host: one for 100 contracts at \$1.02 and one for 50 contracts at \$1.02. All 50 contracts from the 2nd AAO will be consummated first at \$1.02. The remaining 40 contracts will

be executed at \$1.02 with the Original AAO. The remaining 60 contracts from the Original AAO will remain on the BOX Book at their original time priority.

Example 4

For this example assume a second AAO buy order is resting on the BOX Book at \$1.00 that does not have time priority over the Original AAO (referred to in this example as the “2nd AAO”). The 2nd AAO is for 50 contracts with an AAO Maximum Improvement Price is \$1.04. A market order to sell 75 contracts of XYZ is entered into the Trading Host and an Improvement Auction commences. During the Improvement Auction an Improvement Order to buy XYZ is entered at \$1.01. Upon completion of the Improvement Auction, the 50 contracts of the 2nd AAO will be fully executed at \$1.01 and the Original AAO will fill the remaining 25 contracts of the market order to sell at \$1.01. Even though the Original AAO has time priority over the 2nd AAO, the 2nd AAO will be filled first because it has a higher AAO Maximum Improvement Price (\$1.04 vs. \$1.03) than the Original AAO.

Example 5

For this example, assume that while the Original AAO is resting on the BOX Book, but prior to an Improvement Auction commences, another AAO to sell 80 XYZ is entered into the Trading Host at \$1.01 (referred to in this example and in Example 6 as the “2nd AAO”). These two orders will immediately be matched and traded at \$1.02, the mid-point of the two AAO Maximum Improvement Prices. The remaining 20 contracts from the Original AAO will remain on the BOX Book with its original time price priority.

Example 6

For this example, assume everything is the same as in Example 5 except the 2nd AAO to sell 80 XYZ is entered into the Trading Host at \$1.02. The executions will remain the same as in

Example 5 except the price will be rounded (the midpoint of \$1.02 and \$1.03 is \$1.025) to the nearest penny increment towards the favor of the Original AAO. Since the Original AAO was already on the BOX Book, the trade will execute at \$1.02. The remaining 20 contracts from the Original AAO will remain on the BOX Book with its original time price priority.

Conclusion

As shown by the above examples, the AAO causes no detriment to customers or the markets as a whole, will increase the number of Improvement Orders that will be available to participate in an Improvement Auction and thus creates a greater possibility for better execution prices on all orders placed on BOX.

2. Statutory Basis

The proposal is consistent with the requirements of Section 6(b) of the Act,⁶ in general, and Section 6(b)(5) of the Act,⁷ in particular, in that it makes it easier for non-professional customers to participate in Improvement Auctions, it is generally designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts 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

The Exchange has neither solicited nor received comments on the proposed rule change.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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 BSE consents, the Commission shall: (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-2006-56 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-BSE-2006-56. 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. Copies of such filing also will be available for inspection and copying at the principal office of the BSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BSE-2006-56 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Florence E. Harmon
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).