

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-59197; File No. SR-BSE-2008-52)

January 5, 2009

Self-Regulatory Organizations; The Boston Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Amend BOX Rules Relating to Obvious Error Provisions to Address Catastrophic Errors, Erroneous Quotes or Prints in the Underlying Security, and Some Additional Modifications

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 24, 2008, the Boston Stock Exchange, Inc. (“BSE” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by BSE. The Exchange filed the proposed rule change as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. 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 Chapter V, Section 20 (Obvious Errors) of the Rules of the Boston Options Exchange Group, LLC (“BOX”) to address catastrophic errors (“Catastrophic Errors”) as well as erroneous quotes or prints in the underlying security and some additional modifications to this section. The text of the proposed rule change is available from the principal office of the Exchange, at the Commission’s Public Reference Room and also on

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

the Exchange's Internet website at

http://nasdaqtrader.com/Trader.aspx?id=Boston_Stock_Exchange.

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 self-regulatory organization 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 self-regulatory organization 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

The purpose of the proposed rule change is to amend Chapter V, Section 20 of the BOX Rules (the "Obvious Error Rule") to address certain extreme circumstances. In particular, the Exchange proposes to add criteria for identifying "Catastrophic Errors" and making adjustments when Catastrophic Errors occur, as well as a streamlined procedure for reviewing actions taken in these extreme circumstances. This proposed rule change also seeks to incorporate provisions within the BOX Obvious Error Rule which will allow for the nullification or adjustment of trades that are the result of either an erroneous quote or print in the underlying security. In addition, the proposed rule also amends the Supplementary Material to remove references to a \$.05 offer and to provide that executions may be busted, if at least one strike below (for calls) or above (for puts), rather than the three strikes.

The Exchange notes that, currently under the Obvious Error Rule, trades that result from an Obvious Error may be adjusted or busted according to objective standards. Under the rule,

whether an Obvious Error has occurred is determined by comparing the execution price to the Theoretical Price of the option. The rule requires that Participants notify the Market Operations Center (“MOC”) within a short time period following the execution of a trade (five minutes for market makers and 20 minutes for non-market makers) if they believe the trade qualifies as an Obvious Error. Trades that qualify for adjustment are adjusted under the rule to a price that matches the Theoretical Price plus or minus an adjustment value, which is \$.15 if the theoretical value is under \$3 and \$.30 if the theoretical value is at or above \$3. By adjusting trades above or below the Theoretical Price, the rule assesses a “penalty” in that the adjustment price is not as favorable as what the party making the error would have received had it not made the error.

In formulating the Obvious Error Rule, the Exchange has weighed carefully the need to assure that one market participant is not permitted to receive a wind-fall at the expense of another market participant that made an Obvious Error, against the need to assure that market participants are not simply being given an opportunity to reconsider poor trading decisions. The Exchange states that, while it believes that the Obvious Error Rule strikes the correct balance in most situations, in some extreme situations, Participants may not be aware of errors that result in very large losses within the time periods required under the rule. In this type of extreme situation, the Exchange believes Participants should be given more time to seek relief so that there is a greater opportunity to mitigate very large losses and reduce the corresponding large wind-falls. However, to maintain the appropriate balance, the Exchange believes Participants should only be given more time when the execution price is much further away from the Theoretical Price than is required for Obvious Errors, and that the adjustment “penalty” should be much greater, so that relief is only provided in extreme circumstances.⁵

⁵ The Exchange does not believe the type of extreme situation that is covered by the proposed rule would occur in the normal course of trading. Rather, this type of situation

Accordingly, the Exchange proposes to amend the Obvious Error Rule to address “Catastrophic Errors.” Under the proposed rule, Participants will have until 8:30 a.m. Eastern Time on the day following the trade to notify the MOC of a potential Catastrophic Error. For trades that take place in an expiring series on expiration Friday, Participants must notify the MOC of a potential Catastrophic Error by 5:00 p.m. Eastern Time that same day. Once a Participant has notified the MOC of a Catastrophic Error within the required time period, the Market Regulation Center (“MRC”) will review the Catastrophic Error claim.

A Catastrophic Error would be deemed to have occurred when the execution price of a transaction is higher or lower than the Theoretical Price for the option by an amount equal to at least the amount shown in the second column of the chart below (the “Minimum Amount”), and the adjustment would be made plus or minus the amount shown in column three of the chart below (the “Adjustment Value”). At all price levels, the Minimum Amount and the Adjustment Value for Catastrophic Errors would be significantly higher than for Obvious Errors, which the Exchange believes, would limit the application of the proposed rule to situations where the losses are very large.

Theoretical Price	Minimum Amount	Adjustment Value
Below \$2	\$1	\$1
\$2 to \$5	\$2	\$2
Above \$5 to \$10	\$5	\$3
Above \$10 to \$50	\$10	\$5
Above \$50 to \$100	\$20	\$7

could potentially occur as a result of, for example, an error in a Participant’s quotation system that causes a market maker to severely misprice an option.

Above \$100	\$30	\$10
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The following example demonstrates how the proposed Catastrophic Error provisions would operate within the Obvious Error framework. Assume a Participant notifies the MOC within 2 minutes of a trade where 100 contracts of an option with a Theoretical Price of \$9 were purchased for \$17, resulting in an \$80,000 error.⁶ The trade would qualify as an Obvious Error because the purchase price is more than \$.50 above the Theoretical Price and the Participant notified the MOC within the required time period. The Exchange would review the trade and either bust it or adjust it to a purchase price of \$9.30,⁷ which reduces the cost of the error to \$3,000.⁸ If, however, the Participant failed to identify the same error and notify the MOC until four hours after the trade, it may not be reviewed under the current Obvious Error Rule. Under the proposal, this trade would qualify as a Catastrophic Error because the purchase price is more than \$5 above the Theoretical Price. Under the proposal, the MRC would review the trade and adjust the purchase price to \$12, which reduces the cost of the error to \$30,000.⁹

The Exchange believes that the proposed longer time period is appropriate to allow Participants to discover, and seek relief from, trading errors that result in extreme losses. At the same time, the Exchange believes that the proposed Minimum Amounts required for a trade to qualify as a Catastrophic Error, in combination with the large Adjustment Values, assures that only those transactions where the price of the execution results in very high losses will be eligible for adjustment under the new provisions. While the Exchange believes it is important to

⁶ One hundred contracts equal 10,000 shares, and the purchase price is \$8 per share above the Theoretical Price. Therefore, the purchaser paid \$80,000 over the theoretical value.

⁷ See Proposed Chapter V, Section 20(g)(ii) of the BOX Rules.

⁸ 10,000 shares at \$.30 per share over the theoretical value.

⁹ 10,000 shares at \$3.00 per share over the theoretical value.

identify and resolve trading errors quickly, it also believes it is important to the integrity of the marketplace to have the authority to mitigate extreme losses resulting from errors. In this respect, the Exchange believes that the above example illustrates how market participants would continue to be encouraged to identify errors quickly, as losses will be significantly lower if the erroneous trades are busted or adjusted under the Obvious Error provisions of the rule.

In consideration of the extreme nature of situations that will be addressed under the proposed Catastrophic Error provisions, the Exchange proposes a streamlined procedure for making determinations and adjustments. Under the current rule for Obvious Errors, the MRC makes determinations that can then be appealed to the Boston Options Exchange Regulation (“BOXR”) Chief Regulatory Officer (“CRO”). For Catastrophic Errors, the Exchange proposes to have a one-step process where the MRC, with the approval of the CRO or an Options Official,¹⁰ who is not a Participant, designated by the CRO (“CRO or designee”) makes determinations and adjustments. If it is determined that a Catastrophic Error has occurred, the CRO or its designee will instruct the MRC to adjust the execution price of the transaction(s) according to proposed subparagraph (g) (iii). All determinations by the CRO or its designee shall constitute final Exchange action on the matter at issue. The Exchange encourages Participants to request reviews only in appropriate situations, particularly given the objective criteria used to determine whether a Catastrophic Error occurred and the considerable amount of time Participants are given under the proposal to assess whether a trade falls within that criteria.

Additionally, the Exchange proposes to amend the Obvious Error Rule to address an occurrence of an erroneous quote or print in the underlying security. Participants on BOX base

¹⁰ See BOX Rules Chapter I, Section 1(43) which defines “Options Official” as an officer of BOX Regulation vested by the BOX Regulation Board with certain authority to supervise option trading on BOX.

the value of their quotes and orders off of the price of underlying security. The two provisions which the Exchange proposes to add to the BOX Obvious Error Rule cover instances where the information that the Participants are using to price options is erroneous, through no fault of their own. An erroneous quote or print in an underlying security, which is disseminated by the Primary Market¹¹ for that security, means that Participants are receiving erroneous information which they then incorporate into trading decisions. In these instances, Participants have little if any chance of pricing options accurately. In order to provide relief from transactions that occur as a result of these erroneous quotes and/or prints, the Exchange proposes the following provisions.

Chapter V, Section 20(d) Erroneous Print in Underlying

An electronic trade resulting from an erroneous print disseminated by the Primary Market which is later cancelled or corrected by that Primary Market may be nullified. In order to be nullified, however, the trade must be the result of an erroneous print that is higher or lower than the average trade in the underlying security during a two-minute period before and after the erroneous print by an amount at least five times greater than the average quote width for such underlying security during the same period. For purposes of this paragraph, the average trade in the underlying security shall be determined by adding the prices of each trade during the four minute time period referenced above (excluding the trade in question) and dividing by the number of trades during such time period (excluding the trade in question). For purposes of this paragraph, the average quote width shall be determined by adding the quote widths of each separate quote during the four minute time period referenced above (excluding the quote in

¹¹ See BOX Rules Chapter I, Section 1(50) which defines “Primary Market” as the principal market where the underlying security is traded.

question) and dividing by the number of quotes during such time period (excluding the quote in question).

Chapter V, Section 20(e) Erroneous Quote in Underlying

Trades resulting from an erroneous quote in the underlying security may be adjusted or nullified as set forth in Chapter V, Section 20(f). An erroneous quote occurs when the underlying security has a width of at least \$1.00 and has a width at least five times greater than the average quote width for such underlying security on the Primary Market (as defined in BOX Rules Chapter I, Section 1(50)) during the time period encompassing two minutes before and after the dissemination of such quote. For purposes of this paragraph, the average quote width shall be determined by adding the quote widths of each separate quote during the four minute time period referenced above (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question) and dividing by the number of quotes during such time period (excluding the quote in question).

These proposed rule changes will provide Participants on BOX with the same opportunities for price adjustment or trade nullification that are available on other options exchanges. The Exchange notes that these provisions are similar in all respects to rules already approved for use at The Chicago Board Options Exchange (“CBOE”),¹² The American Stock Exchange (“Amex”),¹³ and NYSE Arca.¹⁴

In addition, the proposed rule also amends the Supplementary Material to remove references to a \$.05 offer. The Exchange also proposes to provide that buyers of options with a zero bid may request their execution be busted, if at least one strike below (for calls) or above

¹² See CBOE Rules 6.25(a)(4)-(5).

¹³ See Amex Rules 936-ANTE(a)(4)-(5).

¹⁴ See NYSE Arca Rules 6.87(a)(4)-(5).

(for puts), in the same options class were quoted with a zero bid at the time of execution rather than the three strikes, which is currently in the rule. Removing the references to a \$.05 offer will allow errors resulting from trades in penny pilot issues be treated in the same manner as non-penny classes. Moreover, these proposed changes will provide Participants on BOX with similar opportunities for price adjustment or trade nullification that are available on other options exchanges.¹⁵

2. Statutory Basis

The Exchange believes that the proposal is consistent with the requirements of Section 6(b) of the Act,¹⁶ in general, and Section 6(b)(5) of the Act,¹⁷ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Specifically, the proposal will, under certain circumstances, provide Participants with the opportunity for a longer period within which to seek relief from errors that result in large losses. The proposal is also appropriate given that it provides for the adjustment or nullification of trades which are executed at clearly erroneous prices due to no fault of the parties to the trade. Finally, removing the references to a \$.05 offer in the Supplementary Material will allow errors resulting from trades in penny pilot issues be treated in the same manner as non-penny classes.

¹⁵ See e.g. CBOE Rules 6.25(a)(2); Amex Rules 936-ANTE(a)(2).

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78f(b)(5).

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 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.

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

Because the foregoing proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁸ and Rule 19b-4(f)(6) thereunder.¹⁹

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

¹⁸ 15 U.S.C. 78s(b)(3)(A).

¹⁹ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. BSE has satisfied this requirement.

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act²⁰ normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)²¹ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. BSE requests that the Commission waive the 30-day operative delay to immediately offer market participants on BSE the same potential for relief that is available at other options exchanges for certain obvious errors, catastrophic errors, or erroneous quotes or prints in the underlying security. The Exchange stated that the proposed changes are not novel and are necessary to eliminate any confusion among members of multiple exchanges regarding the handling and treatment of requests for review of Catastrophic Errors and instances of erroneous quotes or prints in the underlying security and for purposes of maintaining a fair and orderly market. The Commission believes that waiving the 30-day operative delay²² is consistent with the protection of investors and the public interest. Given that the Exchange's proposed rule change is substantially similar to the rules of other exchanges previously approved by the Commission, the proposal does not appear to present any novel regulatory issues. Therefore, the Commission designates the proposal as operative upon filing.

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:

²⁰ 17 CFR 240.19b-4(f)(6).

²¹ Id.

²² For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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 SR-BSE-2008-52 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 SR-BSE-2008-52. 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 a.m. and 3:00 p.m. 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 publicly available. All submissions should refer to File

Number SR-BSE-2008-52 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²³

Florence E. Harmon
Deputy Secretary

²³ 17 CFR 200.30-3(a)(12).