

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49771; File No. SR-BSE-2003-09)

May 25, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 thereto by the Boston Stock Exchange, Inc. Relating to the Extension of Certain Listed Trading Rules to the Trading of Nasdaq Securities

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 July 2, 2003, 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 prepared by the Exchange. On April 5, 2004, the Exchange amended the proposed rule change.³ On May 6, 2004, the Exchange amended the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from John Boese, Vice President, Legal and Compliance, Exchange, to Nancy Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated April 2, 2004 (“Amendment No. 1”). In Amendment No. 1, the Exchange restated the proposed rule change in its entirety.

⁴ See letter from John Boese, Chief Regulatory Officer, Exchange, to Nancy Sanow, Assistant Director, Division, Commission, dated May 5, 2004 (“Amendment No. 2”). In Amendment No. 2, the Exchange restated the proposed rule change in its entirety.

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

The Exchange seeks to extend certain of its listed trading rules to the trading of Nasdaq securities. The text of the proposed rule change, as amended, is set forth below. Proposed new language is in italics.

* * * * *

Chapter XXXV

Trading in Nasdaq Securities

Competing Specialist Initiative

Section 30. Any specialist can apply to the Exchange to function as a competing specialist pursuant to these procedures:

1. Applications to compete must be directed to the Market Performance Committee in writing and must list in order of preference the stock(s) in which the applicant intends to compete. The Market Performance Committee will use the following guidelines in reviewing an application:

- overall performance evaluation results of the applicant
- financial capability
- adequacy of manpower on the floor
- objection by the regular specialist in a stock, with or without cause

2. Objections to Competition

a. Any objection¹ by the regular specialist to permit competition in one or more of such specialist's stocks must be in writing on a form designated by the Exchange and filed with the Exchange within 24 hours² of notice³ of the competing specialist's application.

b. A Market Performance Committee meeting will be scheduled to review the reasons for objection, and to determine whether an entering competitor could jeopardize the fair and orderly market maintained by the regular specialist in relation to the stock at issue. The regular specialist will be permitted to appear before the Committee to give the Committee the opportunity to question the regular specialist in regard to the reasons for objection. The applicant (competitor) will also be permitted to appear before the Committee to respond to any issues raised. After the Market Performance Committee renders its decision, either party may appeal to the Executive Committee and then, if necessary, to the Board of Governors.⁴

c. Pending Market Performance Committee review of any objection, competition in the security may be permitted upon the affirmative determination of a majority of the floor members of the Market Performance Committee, based on the standard set forth in Paragraph b. of this Section 30. Pending the outcome of any appeal process, competition in the security at issue will be permitted. The results of such competition may be used by either the regular specialist in support of their objection, or considered by the Market Performance Committee, Executive Committee, or Board of Governors, in their respective determinations.

3. All applicants must be registered with the Exchange as specialists and must meet the current minimum requirements for specialists set forth in Chapter XV, the minimum capital and equity requirements as set forth in Chapters VIII and XXII of the Rules of the Exchange, and conform to all other performance requirements and standards set forth in the Rules of the Exchange. A competing

specialist will be subject to all of the rules and policies applicable to a regular specialist.

4. All applicant organizations, existing or newly created, must satisfy the Market Performance Committee that they have sufficient manpower to enable them to fulfill the functions of a specialist as set forth in Chapter XV in all of the stocks in which the applicant will be registered either as a regular or a competing specialist.

5. The regular specialist will receive all order flow not specifically directed to a competitor.

6. The specialist/competing specialist is responsible for all orders directed to him/her.

7. In any competitive situation, if either the regular specialist to whom a stock was originally assigned or the specialist organization which subsequently received approval to compete with the regular specialist desires to terminate the competition by requesting that it be relieved of the stock that is the subject of the competition, it should so notify the Market Performance Committee at least three business days prior to the desired effective date of such withdrawal. When the regular specialist requests to be relieved of a stock, the stock shall be posted for reallocation by the Stock Allocation Committee. In the interim, if the Market Performance Committee is satisfied that the competing specialist can continue to maintain a fair and orderly market in such stock, the competing specialist shall serve as the regular specialist until the stock has been reallocated.⁵ Where there is

more than one competing specialist in the stock, Exchange staff shall place the stock with a caretaker until reallocation.

8. Any competing specialist who withdraws his/her registration in a stock will be barred from applying to compete in that same stock for a period of ninety (90) days following the effective date of withdrawal.

9. Notwithstanding the existence of competing specialist situations, there is only one Exchange market in a security subject to competition. Due to the ease of communications on the Floor via the Stentofon System, it will not be necessary to locate competing specialists adjacent to each other. However, all specialists must be responsible for their portion of the published bid and/or offer, and the Exchange's Nasdaq trading system will update quotations accordingly. Also, competitors must cooperate with the regular specialist regarding openings and reopenings to ensure that they are unitary.

10. Because there is only one Exchange market in a security subject to competition, all limit orders sent to the Exchange will be maintained by the Exchange's Nasdaq trading system's central limit book and will be executed strictly according to time priority as to receipt of the order in the system, irrespective of firm order routing procedures. This rule shall not be applicable where the quotation on the book is for the account of a specialist/competing specialist and another specialist/competing specialist has received an order directed to him. In such event, the specialist/competing specialist can elect to execute the order for his own account at the same price as the other

specialist/competing specialist's order, or a better price, or to permit the order to be executed against the specialist/competing specialist's quotation.

11. Competing specialists must keep each other informed and communicate to inquiring Floor brokers the full size of any executable "all or none" orders in their possession since all-or-none orders cannot be represented in the published quote. The competing specialists are expected to represent such orders on a "best efforts" basis to ensure the execution of the entire order at a single price or prices, or not at all.

12. The registration of any competing specialist may be suspended or terminated by the Market Performance Committee upon a determination of any substantial or continued failure by such competing specialist to engage in dealings in accordance with the Constitution and Rules of the Exchange.

1 Only the regular specialist can object to competition in his/her stocks.

2 Unless the regular specialist is unavailable, in which case within 24 hours of becoming available.

3 Once an application is received by the Exchange, notification will be issued to the regular specialist(s) in whose stocks competition is being sought.

4 All appeals must be submitted within ten (10) business days of the final decision of either the Market Performance Committee or the Executive Committee.

5 Once the stock has been reallocated to a regular specialist, that specialist shall not be permitted to object to competition in such stock.

Remote Trading in Nasdaq Securities

Section 31. Nasdaq trading terminals and related equipment will be provided by the Exchange to remote member firm locations for specialist trading. The remote terminals will be linked to the Exchange's Nasdaq trading system and will provide the same functionality as is available to on-floor specialists. The following shall apply to specialists participating in Nasdaq Remote trading:

(a) All rules and policies of the Board of Governors of the Exchange shall apply except as specifically excluded or amended under this section.

(b) Any eligible firm may apply to the Market Performance Committee to participate in remote trading. All applicants must meet the current minimum requirements for Nasdaq specialists set forth in Chapters XV (Specialists) and XXXV (Trading in Nasdaq Securities) including, but not limited to their background, experience, staffing, training procedures, adequacy of applicant's proposed confidentiality policy, adequacy of applicant's contingency plans for communication or technology failures, adequacy of applicant's offsite facilities, performance standards and the minimum margin, capital and equity requirements as set forth in Chapters VIII and XXII of the Rules of the Exchange, and conform to all other performance requirements and standards set forth in the Rules of the Exchange.

(c) Unless the Market Performance Committee specifically authorizes otherwise, participating member firms shall be prohibited from trading remotely any Nasdaq securities which are currently being traded on-floor by that individual member firm. In evaluating a member firm's petition for changing the location of where a particular security is traded, the Market Performance Committee shall consider the application in

light of the requirements set forth in paragraph (b) above. Individual securities, however, may not be traded by one specialist firm in more than one location under any circumstances.

(d) All rule references pertaining to the trading floor of the Exchange, including:

Chapter I-B, Section 2 ("Dealings on Floor - Hours");

Chapter I-B, Section 3 ("Dealings on Floor - Persons");

Chapter II, Section 2 ("Recording of Sales");

Chapter II, Section 6 ("Bids and Offers for Stocks");

Chapter II, Section 9 ("Trading for Joint Account");

Chapter II, Section 10 ("Discretionary Transactions");

Chapter II, Section 13 ("Trading Against Privileges");

Chapter II, Section 15 ("Record of Orders from Offices to Floor");

Chapter II, Section 23 ("Dealing on Other Exchanges, or Publicly Outside the Exchange");

Chapter II, Section 31 ("Offering Publicly on the Floor");

Chapter VIII, Section 2 ("Member Organization Account");

Chapter XV, Section 1 ("Registration");

Chapter XV, Section 2 ("Responsibilities");

Chapter XV, Section 3 ("Code of Acceptable Business Practices for Specialists");

Chapter XV, Section 5 ("Preference on Competitive Basis");

Chapter XV, Section 6 ("The Specialist's Book");

Chapter XV, Section 9 ("Opening Listed Stock");

Chapter XV, Section 10 ("Hours");

Chapter XV, Section 16 ("Status of Orders When Primary Market Closed");

Chapter XV, Section 18 ("Procedures for Competing Specialists");

Chapter XV ("Special Offerings");

Chapter XVIII, Section 1 ("Penalties");

Chapter XVIII, Section 4 ("Imposition of Fines for Minor Violation(s) of Rules and Floor Decorum Policies");

Chapter XX, Section 6 ("Gratuities");

Chapter XXII, Section 2 ("Capital and Equity Requirements");

Chapter XXXI, Section 2 ("Intermarket Trading System");

Chapter XXXI, Section 3 ("Pre-Opening Application");

Chapter XXXIV ("Minor Rule Violations"); and

Chapter XXXV ("Trading in Nasdaq Securities")

shall be deemed to include any trading done remotely through the Exchange's Nasdaq trading system, and all such trades shall be deemed to be Boston executions on the Exchange.

(e) A written confidentiality policy regarding the location and access to information, terminals and equipment must be adopted by the firm and filed with and approved by the Exchange prior to the commencement of remote trading. Moreover, this policy must conform to all of the requirements set forth in the Rules of the Exchange, including, but not limited to Chapter XV, Section 6 (The Specialist Book), Chapter II, Section 36 (Specialist Member Organizations Affiliated with an Approved Person), and Section 37 (ITSFEA Procedures). In accordance therewith, reasonable principles must be applied to limit access by non-specialists to Remote Specialist facilities and information,

and to limit Remote Specialists access to and from other proprietary trading venues, including access from outcry or visible communication, intentional or otherwise.

(f) Floor policies regarding dress code, and smoking shall not apply. Access to the area designated as that of the Remote Specialist's shall be restricted to the specialist, backup specialist, clerks and designated management of the specialist (operation), and Exchange authorized personnel, consistent with the Rules of the Exchange, including, but not limited to, "Chinese Wall" procedures set forth in Chapter II, Section 36 (Specialist Member Organizations Affiliated with an Approved Person), and procedures set forth in Chapter XV, Section 6 (The Specialist's Book).

(g) All Exchange correspondence, memoranda, bulletins and other publications shall be sent to the Exchange's Nasdaq Remote Specialists via electronic means and via U.S. mail or overnight delivery.

(h) All Exchange Nasdaq Remote Specialists will have stentofon (or a similarly operational speakerphone), as well as dedicated telephone access, to the physical trading floor. Any regulatory requirements including trading halts, trading practices, policies, procedures or rules requiring floor official involvement will be coordinated by Exchange personnel with the remote specialist through the dedicated telephone line.

(i) Servicing of the Exchange's Nasdaq trading system terminals and related equipment shall be by Exchange authorized and trained personnel only.

(j) The Exchange's examination program of non-DEA floor members would include the remote specialist operations. Every firm must submit specific supervisory procedures relating to the Remote Specialist operations and appropriate identification of

all individuals who will have access to the Remote Specialist operation, including all supervisory personnel.

(k) Any arbitration or disciplinary action arising out of trading activity pursuant to this section would be held at the physical offices of the Exchange located in Boston.

(l) Each remote Nasdaq terminal assigned and registered by the Exchange will require an ETP, and will be subject to the following:

(1) Each Specialist unit must have at least one registered Exchange seat assigned to the approved specialist.

(a) A specialist may be authorized to obtain additional ETP's for qualified registered clerks to access the BSE's Nasdaq Trading System in support of the Specialist unit.

(b) All specialists and registered clerk ETP holders must be approved by the Market Performance Committee and must meet the following:

(i) file an ETP application form with the BSE Surveillance Department;

(ii) completion of the required floor training program; *

(iii) successful completion of the BSE floor examination within 90 days of application;

(iv) successful completion of the Series 63 (NASAA Uniform State Law Exam), and registration with the Commonwealth of Massachusetts, and;

(v) submission of fingerprint records to the BSE.

(2) Each Specialist unit identified by the member firm will be assigned an account ("give up") and will be evaluated under the Exchange's Specialist Performance Evaluation Program ("SPEP") which currently measures performance in several separate categories comprising a relative overall performance ranking.

Commentary: ...

The Market Performance Committee of the Exchange will consider firm applicants based on a variety of criteria, as identified in Section 31(b), above, including, but not limited to, adequate off-site facilities to ensure compliance with the referenced portions of the Exchange's rules, and adequate capital to manage the risks associated with this program. For every applicant specialist who is not an existing on-floor specialist, a two week on-floor training period will be required, among the purposes of which will be to benefit the relationship between the Boston floor and the remote specialist.

* Training: On-site floor training for at least two weeks would be waived for current floor specialists and registered clerks who transfer to remote specialist operations. The two-week on-site floor-training period could also be waived in exceptional circumstances, if other arrangements are made with and approved by the Exchange. In such exceptional circumstances, a waiver will only be permitted if the Exchange is assured that the person requesting the waiver has made other arrangements that ensure that the person meets all of the requirements listed below. However, the two week on-site floor training period will not be waived for easily remedied reasons such as geographical location or inconvenience, and will include, among other things:

(1) Questioned trade procedures;

(2) Communication procedures with Floor Members, Front Desk Operations, Surveillance, and Systems Support;

(3) Competing Specialist Initiative ("CSI") and Unlisted Trading Privilege ("UTP") applications and procedures;

(4) Stock allocation procedures;

(5) Book or symbol change procedures;

(6) Trading Halt procedures;

(7) Floor official rulings;

(8) Authorizations required for billing, withdrawals, and payment of fines where applicable;

(9) Minor Rule Plan Violations policies and application;

(10) Books and records/reports available;

(11) Explanation of the SPEP categories and similar measurements and procedures;

(12) Certain other rules and policies deemed appropriate by the Exchange (e.g. Limit Order Display Rule, auto-executions, Price Improvement, etc.).

* * * * *

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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at 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

The Exchange proposes to add two new sections to Chapter XXXV of its Rules related to the trading of Nasdaq securities on the Exchange. Both new sections are already existing sections of the BSE rules set forth in other chapters, but are not specifically tailored to the trading of Nasdaq securities on the Exchange. For clarity, the Exchange is seeking to reprint these already existing sections of their rules in Chapter XXXV, with minor revisions so that they are specifically adapted to the trading of Nasdaq securities on the Exchange.

The first section proposed to be added is a reprint of Chapter XV, Dealer Specialists, Section 18, Procedures for Competing Specialists, with minor revisions. This would permit specialists who trade Nasdaq securities on the BSE to avail themselves of the Exchange's competing specialist program. The only changes to the current rule would be to replace references to "BEACON," which is the BSE's trading system for listed securities, with references to the "BSE's Nasdaq Trading System." Otherwise, all provisions of the Competing Specialist Initiative, would apply to the trading of Nasdaq securities in the same way as they do to the trading of listed securities.

The second proposed addition to the Exchange's Nasdaq Trading Rules would be to extend the BSE's BEACON Remote trading program to include Nasdaq trading. As such, the Exchange would republish, in large part, its remote trading rules located in Chapter XXXIII, BEACON, Section 9, BEACON Remote, as a new section in Chapter

XXXV, Trading in Nasdaq Securities. The substance of the rule would not change. For instance, all requirements relating to the applicability of other BSE Rules, confidentiality, “Chinese Walls,” communications, and Electronic Trading Permits would still apply.

The only deletions or amendments would be those necessary to make the rule applicable to the Nasdaq program, and would be administrative and non-substantive in nature.

The Exchange would leave certain provisions of the existing BEACON Remote Rule out of the new section being proposed for the remote trading of Nasdaq securities. For instance, in the introduction to the BEACON Remote Rule, there is a reference to “ITS.” The sentence containing that reference would be dropped from the proposed Remote Nasdaq Rules as ITS is not utilized by the Exchange for transactions in Nasdaq securities. Also, Paragraph (e) of the BEACON Remote Rule would be eliminated in the proposed Remote Nasdaq rules because the Exchange does not have a similar limitation for specialists who trade Nasdaq securities. Likewise, since Paragraph (f) of the BEACON Remote Rule refers to BEACON drop copy, it would not be applicable to the trading of trading Nasdaq securities on the exchange, since Nasdaq securities are not traded on the Exchange’s BEACON system, and the concept of “drop copy” is a BEACON system feature. And, in proposed Paragraph (f), the Exchange would not include the negative references to “identification and visitors” which are included in the counterpart Paragraph (i) of the BEACON Remote Rule. This is because the Exchange has deemed these to be important provisions which should be included in the procedures and policies of a firm that wishes to trade Nasdaq securities remotely on the BSE. Finally, the Exchange is proposing to omit much of the Commentary from the BEACON Remote Rule in its Remote Nasdaq Rule proposal due to the fact that the Commentary

was largely devoted to the initial stages of the remote trading program. Since the Exchange has been trading remotely for over four years, it considers the initial stages of the program to have concluded.

As with current BEACON Remote locations, the Exchange's Compliance Department would physically inspect each remote Nasdaq location. A written approval form detailing the physical layout of each location would be required to be executed by and filed with the Exchange prior to the commencement of any trading activity from the remote location. The written approval form would detail the measures taken by the firm to limit access to the remote specialist, with particular attention directed to the steps taken to comply with (i) "Chinese Wall" procedures set forth in Chapter II, Section 36 (Specialist Member Organizations Affiliated with an Approved Person), (ii) Chapter XV, Section 6 (The Specialist Book), and (iii) Chapter II, Section 37 (ITSFEA Procedures). The Exchange also would reserve the right to inspect the premises of all remote specialists, with or without notice, during reasonable business hours, at any point during which the specialist is actively trading on the BSE, in addition to routinely scheduled physical inspections.

In order that the Exchange would be able to individually identify and associate a remote Nasdaq terminal with an individual specialist or clerk, the Exchange is seeking to copy those provisions of the BEACON Remote Rule relating to Electronic Trading Permits ("ETPs"). The ETPs are non-transferable permits that would be primarily used for surveillance purposes. The Exchange would specifically authorize and approve each ETP based on certain qualifications, and the ETP would be required in addition to the Exchange's membership conditions.

The ETP provisions, among other things, require that all registered specialists and clerks complete a floor-training program, unless waived as discussed below, as well as successfully complete the BSE floor examination and the Series 63 (NASAA Uniform State Law Exam). The two-week floor-training program would be waived for current floor specialists and registered clerks who transfer to remote specialist operations. The training period could also be waived for other people in exceptional circumstances, if other arrangements were to be made and approved by the Exchange. In such exceptional circumstances, a waiver would only be permitted if the Exchange was assured that the person requesting the waiver has made other arrangements that ensure that the person would meet all of the training requirements listed in the proposal.⁵ However, the two-week on-site training period would not be able to be waived for easily remedied reasons such as geographical location or inconvenience. Furthermore, each registered clerk in a remote location, who qualifies for an ETP, would be required to operate under the direct supervision of a registered specialist, just as a registered clerk is supervised in the on-floor environment.

2. Statutory Basis

The Exchange believes that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act⁶ in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in

⁵ According to the BSE, the on-site floor training includes, among other things: communication procedures with Front Desk Operations, Surveillance, Systems Support; Competing Specialist Initiative and Unlisted Trading Privilege applications and procedures; stock allocation procedures; trading halt procedures; and books and records/reports available.

⁶ 15 U.S.C. 78f(b)(5).

regulating, clearing, settling, processing information with respect to, and 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.

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

The Exchange does not believe that the proposed rule change, as amended, 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

No written comments were solicited or 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 self-regulatory organization consents, the Commission will:

- A. by order approve such proposed rule change, as amended, or
- B. institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, 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 Number SR-BSE-2003-09 on the subject line.

Paper comments:

Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-BSE-2003-09. 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 the 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-2003-09 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.⁷

Margaret H. McFarland
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).