

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60349; File No. SR-BX-2009-035)

July 20, 2009

Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Establish Procedures to Prevent Information Advantages Resulting From the Affiliation Between BOX and NOS.

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 17, 2009, NASDAQ OMX BX, Inc. (the “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange has designated the proposed rule change as constituting a non-controversial rule change under Rule 19b-4(f)(6) under the Act,³ 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 a rule change to establish procedures designed to prevent potential informational advantages resulting from the affiliation between the Boston Options Exchange (“BOX”), a facility of the Exchange, and NASDAQ Options Services, LLC (“NOS”), a registered broker-dealer and a BOX market participant. 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 the Exchange’s Internet website at

<http://nasdaqomxbx.cchwallstreet.com/NASDAQOMXBX/Filings/>.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 17 CFR 240.19b-4(f)(6).

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. 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 NASDAQ OMX Group, Inc. ("NASDAQ OMX") acquired the Exchange in August 2008. Prior to the acquisition, the Exchange owned a 21.87% interest in Boston Options Exchange Group, LLC ("BOX LLC"), the operator of BOX, a facility of the Exchange. Boston Options Exchange Regulation, LLC ("BOXR") is a wholly-owned subsidiary of the Exchange, to which the Exchange has delegated, pursuant to a delegation plan, certain self-regulatory responsibilities related to BOX.

At the closing of the acquisition by NASDAQ OMX, the Exchange transferred its interest in BOX LLC to MX US, a wholly-owned subsidiary of the Montreal Exchange Inc. Although the Exchange no longer holds an ownership interest in BOX LLC, it continues to hold self-regulatory obligations with respect to BOX. The Exchange, together with BOXR, retains regulatory control over BOX and the Exchange, as the SRO, remains responsible for ensuring compliance with the federal securities laws and all applicable rules and regulations.

NASDAQ OMX also currently indirectly owns NASDAQ Options Services, LLC (“NOS”), a registered broker-dealer and a BOX market participant. Thus, NOS is deemed an affiliate of the Exchange, BOX and BOXR.

The Exchange is proposing that NOS be permitted to route certain orders from The NASDAQ Option Market (“NOM”) to BOX without checking the NOM book prior to routing. NOM is an options market operated by The NASDAQ Stock Market (the “NASDAQ Exchange”) and NOS is the approved outbound routing facility of the NASDAQ Exchange for NOM. With the exception of Exchange Direct Orders, all routable orders for options that are trading on NOM check the NOM book prior to routing. In addition, NOS also routes orders in options that are not trading on NOM (referred to in the NOM Rules as “Non-System Securities”). When routing orders in options that are not listed and open for trading on NOM, NOS is not regulated as a facility of the NASDAQ Exchange but rather as a broker-dealer regulated by its designated examining authority. As provided by Chapter IV, Section 5 of the NOM Rules, all orders routed by NOS under these circumstances are routed to away markets that are at the best price, and solely on an immediate-or-cancel basis.

Under NOM Rule Chapter VI, Section 11: 1) NOM routes orders in options via NOS, which serves as the sole “routing facility” of NOM; 2) the sole function of the routing facility is to route orders in options to away markets pursuant to NOM rules, solely on behalf of NOM; 3) NOS is a member of an unaffiliated self-regulatory organization, which is the designated examining authority for the broker-dealer; 4) the routing facility is subject to regulation as a facility of the NASDAQ Exchange, including the requirement to file proposed rule changes under Section 19 of the Act; 5) NOM must establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary

information between the NASDAQ Exchange and its facilities (including the routing facility), and any other entity; and 6) the books, records, premises, officers, directors, agents, and employees of the routing facility, as a facility of the NASDAQ Exchange, shall be deemed to be the books, records, premises, officers, directors, agents, and employees of the NASDAQ Exchange for purposes of and subject to oversight pursuant to the Act, and the books and records of the routing facility, as a facility of the NASDAQ Exchange, shall be subject at all times to inspection and copying by the NASDAQ Exchange and the Commission.

The Commission has approved NOS's affiliation with the Exchange subject to the conditions that: (1) NOS is a facility of the NASDAQ Exchange; (2) use of NOS's routing function by NASDAQ Exchange members is optional⁴ and (3) NOS does not provide routing of orders in options from NOM to the Exchange or any trading facilities thereof, unless such orders first attempt to access any liquidity on the NOM book.⁵

The NASDAQ Exchange has filed a proposed rule change to modify the last of these conditions to permit NOS to route Exchange Direct Orders in NOM system securities to BOX without checking the NOM book prior to routing.⁶ Exchange Direct Orders are orders that route directly to other options markets on an immediate-or-cancel basis without first checking the

⁴ Because only NASDAQ Exchange members who are Options Participants may enter orders into NOM, it also follows that routing by NOS is available only to NASDAQ Exchange members who are Options Participants. Pursuant to Chapter I, Section 1(a)(40) of the NOM Rules, the term "Options Participant" means a firm, or organization that is registered with the NASDAQ Exchange for purposes of participating in options trading on NOM as a "Nasdaq Options Order Entry Firm" or "Nasdaq Options Market Maker".

⁵ See Securities Exchange Act Release No. 58324 (August 7, 2008), 73 FR 46936 (August 12, 2008)(SR-BSE-2008-02; SR-BSE-2008-23; SR-BSE-2008-25; SR-BSECC-2008-01).

⁶ SR-NASDAQ-2009-065.

NOM book for liquidity.⁷ In addition, the proposed rule change would permit the routing by NOS of orders (including Exchange Direct Orders) in NOM non-system securities from NOM to BOX.

The principles that govern the routing of orders to an exchange by an affiliated broker-dealer are well-established. The Exchange and other exchanges previously have adopted rules that permit exchanges to accept routing of inbound orders from affiliates, subject to certain limitations and conditions intended to address the Commission's concerns regarding affiliation.⁸ In the orders approving these rule changes, the Commission noted its concerns about potential informational advantages and conflicts of interest between an exchange's self-regulatory obligations and its commercial interest when the exchange is affiliated with one of its members, but determined that the limitations and conditions proposed in the rule changes were sufficient to mitigate its concerns.

To appropriately address the concerns raised by the Commission regarding the potential for conflicts of interest and informational advantages, the Exchange is proposing certain restrictions and undertakings. These commitments are consistent with the undertakings made by the NASDAQ Exchange and the Exchange in adopting rule changes to permit the Exchange's

⁷ NOM Rule Chapter VI, Section (1)(e)(7).

⁸ See Securities Exchange Act Release Nos. 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008)(SR-BSE-2008-48); 59010 (November 24, 2008), 73 FR 73373 (December 2, 2008) (SR-NYSEArca-2008-130); 58681 (September 29, 2008), 73 FR 58285 (October 6, 2008)(SR-NYSEArca-2008-90); 58680 (September 29, 2008), 73 FR 58283 (October 6, 2008)(SR-NYSE-2008-76); 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008)(SR-Amex-2008-62) (collectively, the "Affiliation Orders").

equity market to accept routing of inbound orders from NASDAQ Execution Services, Inc. in its operation as the routing facility of the NASDAQ Exchange.⁹

In order to manage the concerns raised by the Commission regarding conflicts of interest in instances where a broker-dealer is affiliated with an exchange to which it is routing orders, the Exchange notes that, with respect to orders routed to BOX by NOS, NOS is subject to independent oversight and enforcement by FINRA, an unaffiliated SRO that is NOS's designated examining authority. In this capacity, FINRA is responsible for examining NOS with respect to its books and records and capital obligations and also has the responsibility for reviewing NOS's compliance with applicable trading rules. In addition, the Exchange has entered into a regulatory services agreement with FINRA under which FINRA staff will review NOS's compliance with BOX's rules through FINRA's examination program. FINRA and the Exchange will also monitor NOS for compliance with BOX's trading rules, subject, of course, to Commission oversight of the regulatory program of the Exchange and FINRA. The Exchange will, however, retain ultimate responsibility for enforcing its rules with respect to NOS except to the extent that they are covered by an agreement with FINRA pursuant to Rule 17d-2,¹⁰ in which case regulatory responsibility will be allocated to FINRA as provided in Rule 17d-2(d).

Furthermore, in order to minimize the potential for conflicts of interest, the Exchange and FINRA will collect and maintain all alerts, complaints, investigations and enforcement actions in which NOS (in routing orders to BOX) is identified as a participant that has potentially violated applicable Commission or Exchange rules. The Exchange and FINRA will retain these records in an easily accessible manner in order to facilitate any potential review conducted by the

⁹ See Securities Exchange Act Release Nos. 59153 (December 23, 2008), 73 FR 80485 (December 31, 2008)(SR-NASDAQ-2008-098); 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008)(SR-BSE-2008-48).

¹⁰ 17 CFR 240.17d-2.

Commission's Office of Compliance Inspections and Examinations. FINRA will then provide a report to BOXR's Chief Regulatory Officer, on at least a quarterly basis, which (i) quantifies all alerts (of which the Exchange and FINRA become aware) that identify NOS as a participant that has potentially violated an Exchange or Commission rule and (ii) quantifies the number of all investigations that identify NOS as a participant that has potentially violated an Exchange or Commission rule.¹¹

In order to address the Commission's concerns about potential for information advantages that could place an affiliated broker-dealer at a competitive advantage vis-à-vis other non-affiliated broker-dealers, the Exchange is proposing to amend Chapter XXXIX, Section 2 of the Grandfathered Rules of the Exchange. New Chapter XXXIX, Section 2(c) of the Grandfathered Rules as it applies to BOX will require the implementation of policies and procedures that are reasonably designed to prevent NOS from acting on non-public information regarding BOX's systems prior to the time that such information is made available generally to all market participants of such entity performing inbound routing functions. These policies and procedures would include systems development protocols to facilitate an audit of the efficacy of these policies and procedures.

Specifically, Chapter XXXIX, Section 2(c) shall provide as follows:

The NASDAQ OMX Group, Inc., which owns NASDAQ Options Services, LLC and is affiliated with BOX through its ownership of the Exchange, of which BOX is a facility, shall establish and maintain procedures and internal controls reasonably designed to ensure that NASDAQ Options Services, LLC does not develop or implement changes to its system on the basis of non-public information regarding planned changes to BOX

¹¹ The Exchange, FINRA and SEC staff may agree going forward to reduce the number of applicable or relevant surveillances that form the scope of the agreed upon report.

systems, obtained as a result of its affiliation with BOX, until such information is available generally to similarly situated BOX participants in connection with the provision of inbound routing to BOX.

In addition, existing NOM Rule Chapter VI, Section 11(e) requires NOS to establish and maintain procedures and internal controls reasonably designed to adequately restrict the flow of confidential and proprietary information between the NASDAQ Exchange and its facilities (including NOS) and any other entity.

The Exchange believes these measures will effectively address the concerns identified by the Commission regarding the potential for informational advantages favoring NOS vis-à-vis other BOX participants.

b. Pilot Period

The Exchange is proposing that NOS route Exchange Direct Orders and orders in NOM non-system securities inbound to the Exchange from NOM for a pilot period of 12 months from the operative date of this filing. The Exchange believes that this pilot period is of sufficient length to permit both the Exchange and the Commission to assess the impact of the rule change described herein.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,¹² in general, and with Section 6(b)(5) of the Act,¹³ in particular, in that the proposal 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 regulating, clearing, settling, processing information with respect to, and facilitating transactions

¹² 15 U.S.C. 78f.

¹³ 15 U.S.C. 78f(b)(5).

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. The proposed rule change would permit inbound routing of orders from NOM to BOX through NOS while minimizing the potential for conflicts of interest and informational advantages involved where a broker-dealer is affiliated with an exchange facility to which it is routing orders.

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

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

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

Written comments were neither solicited nor received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁴ and Rule 19b-4(f)(6)¹⁵ thereunder in that it effects a change that: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest.

In its recent guidance on the proposed rules of Self-Regulatory Organizations (“SROs”),¹⁶ the Commission concluded that filings based on the rules of another SRO already

¹⁴ 15 U.S.C. 78s(b)(3)(A).

¹⁵ 17 CFR 240.19b-4(f)(6).

¹⁶ Securities Exchange Act Release No. 58092 (July 3, 2008), 73 FR 40144 (July 11, 2008).

approved by the Commission are eligible for immediate effectiveness under Rule 19b-4(f)(6). The Commission noted that “a proposed rule change appropriately may be filed as an immediately effective rule so long as it is based on and similar to another SRO’s rule and each policy issue raised by the proposed rule (i) has been considered previously by the Commission when the Commission approved another exchange’s rule (that was subject to notice and comment), and (ii) the rule change resolves such policy issue in a manner consistent with such prior approval.”¹⁷ The Exchange believes the proposed rule change is “based on and similar to” the rule changes recently approved in the Affiliation Orders and furthers efforts to effectively address the concerns previously identified by the Commission regarding the potential for conflicts of interest and informational advantages when an exchange is affiliated with one of its market participants.¹⁸ This rule proposal, which is effective upon filing with the Commission, shall become operative 30 days after the date of the filing.

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.

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

¹⁷ Id. at 40149.

¹⁸ See the Affiliation Orders, supra note 8.

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-BX-2009-035 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-BX-2009-035. 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 the 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 Number SR-BX-2009-035 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.¹⁹

Florence E. Harmon
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).