

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-59472; File No. SR-NYSEALTR-2008-14)  
February 27, 2009

Self-Regulatory Organizations; NYSE Alternext US LLC; Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of the Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Establish Rules for the Trading of Listed Options

I. Introduction

On December 19, 2008, NYSE Alternext US LLC ("Alternext" or the "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the rules governing the trading of options on the Exchange. The proposed rule change was published for comment in the Federal Register on December 31, 2008.<sup>3</sup> The Exchange filed Amendment No. 1 to the proposed rule change on February 27, 2009.<sup>4</sup> The Commission received one comment on the proposal.<sup>5</sup> This notice and order provides notice of Amendment No. 1 and grants accelerated approval to the proposed rule change, as modified by Amendment No. 1.

II. Description of the Proposal

On October 1, 2008, NYSE Euronext – the parent company of the New York Stock Exchange ("NYSE") – through a series of mergers and related transactions ("Mergers"), acquired the American Stock Exchange LLC ("Amex"). Amex was renamed NYSE Alternext US LLC

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 59142 (December 22, 2008), 73 FR 80494.

<sup>4</sup> For a discussion of Amendment No. 1, see infra Section III.H.

<sup>5</sup> See letter from Jennifer M. Lamie, Assistant General Counsel, Chicago Board Options Exchange ("CBOE"), to Florence E. Harmon, Deputy Secretary, Commission, dated February 4, 2009.

and became a subsidiary of NYSE Euronext and an affiliate of NYSE.<sup>6</sup> After the Mergers, all physical and electronic access to Alternext's trading facilities was made available to the former Amex's members through temporary trading permits offered by Alternext. As Amex's principal place of business at the time of the Mergers was 86 Trinity Place, New York, New York, these temporary trading permits are known as "86 Trinity Permits."

Subsequently, Amex's cash equities trading floor was moved from 86 Trinity Place to NYSE's principal place of business at 11 Wall Street, New York, New York, and co-located with the NYSE's cash equities trading floor ("Equities Relocation"). The system that supports Alternext's cash equities trading is now the same system that supports NYSE's cash equities trading and is operated by the NYSE on behalf of the Exchange. In connection with the Equities Relocation, the Exchange adopted new trading and membership rules and offered each of its members an Alternext cash equities trading license in exchange for a valid 86 Trinity Permit.<sup>7</sup>

Alternext now proposes to move its options trading business from 86 Trinity Place to 11 Wall Street ("Options Relocation"). In connection with the Options Relocation, the Exchange proposes to issue Amex Trading Permits ("ATPs") that will permit holders to effect options transactions on the Exchange's trading facilities.<sup>8</sup> A holder of an 86 Trinity Permit under the current rules will be issued an ATP upon submission of the appropriate form to the Exchange.

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<sup>6</sup> See Securities Exchange Act Release No. 58673 (September 29, 2008), 73 FR 57707 (October 3, 2008) (order approving proposed rule change relating to the acquisition).

<sup>7</sup> See Securities Exchange Act Release No. 58705 (October 1, 2008), 73 FR 58995 (October 8, 2008).

<sup>8</sup> In addition, the Exchange would allow access to the System by "Sponsored Participants." A Sponsored Participant is a person that has entered into an agreement with a Sponsoring ATP Holder through which it may execute transactions on the System. See proposed Rule 902.1NY(c). This proposed rule is substantially similar to Rule 6.2A of the Rules of NYSE Arca, Inc. ("NYSE Arca").

Trading on the Exchange's relocated facilities at 11 Wall Street will continue to occur on a hybrid system, involving both a physical floor and an electronic system, the NYSE Amex System ("System"). Although the options trading floor will be physically separated from the NYSE and Alternext cash equity trading floor, the options trading floor will be managed and overseen by NYSE Euronext employees. Only ATP Holders that have been approved to perform a floor function – Floor Brokers and Floor Market Makers (including Specialists) – will be authorized to enter into transactions on the trading floor.

Alternext has proposed to update and reorganize its rules for trading options in open outcry and to establish a new set of rules that will govern trading on the System.<sup>9</sup> The Exchange has submitted a separate proposed rule change to delete certain existing Exchange rules.<sup>10</sup>

Alternext will retain many of its existing member rules, including those relating to capital, margin, recordkeeping, customer protection, and account maintenance. The Exchange also has proposed to keep certain existing options-related rules, including rules on position and exercise limits and listing standards. With respect to transactions in Flexible Exchange Options ("FLEX Options") conducted on the Trading Floor, the Exchange stated that current NYSE Alternext Rules 900G through 909G will remain operative.<sup>11</sup>

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<sup>9</sup> In a separate filing, the Exchange described the relationship between the Exchange and its routing broker and the conditions related to its operation. The Commission is approving that proposed rule change in a separate action today. See Securities Exchange Act Release No. 59473 (February 27, 2009) (SR-NYSEALTR-2009-18).

<sup>10</sup> See Securities Exchange Act Release No. 59454 (February 25, 2009) (SR-NYSEALTR-2009-17). The deletions effected by SR-NYSEALTR-2009-17 will become operative simultaneously with the operativeness of the rules proposed in this filing.

<sup>11</sup> The Exchange noted that certain terms in existing NYSE Alternext Rules 900G-909G will become outdated upon approval of the rules proposed herein. The Exchange represented that it will review these rules and will submit a separate filing to revise any outdated references. See Amendment No. 1 at 6.

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>12</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>13</sup> which requires that the rules of an exchange be designed to facilitate transactions in securities; 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 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; and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission also finds that the proposed rule change is consistent with Section 6(b)(8) of the Act<sup>14</sup> in that it does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

Discussed below are the most salient features of the proposal.

#### A. Market Participants

##### 1. Floor Brokers

A Floor Broker as defined in the proposed rules is an ATP Holder who is registered with the Exchange for the purpose, while on the floor, of accepting and executing options orders

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<sup>12</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 15 U.S.C. 78f(b)(8).

received from ATP Holders and, in certain circumstances, orders from others.<sup>15</sup> The proposed rules governing Floor Brokers include general responsibilities to exercise due diligence in representing an order and specific responsibilities with respect to the handling of various order types. These rules are substantially similar to those of NYSE Arca<sup>16</sup> and do not raise any novel or significant issues, and the Commission finds that they are consistent with the Act.

## 2. Market Makers

Currently, the Exchange has four general classifications of Market Maker: Specialist, Registered Options Trader ("ROT"), Supplemental Registered Options Trader ("SROT"), and Remote Registered Options Trader ("RROT"). The Exchange states that these classifications will remain essentially the same under the proposal, although ROTs and SROTs would be combined into one classification as Floor Market Makers ("FMMs"), and RROTs would become Remote Market Makers ("RMMs").

The general term Market Maker in the proposed rules includes Specialists, e-Specialists, FMMs, and RMMs.<sup>17</sup> The Exchange is permitted to appoint one Specialist on the floor per option class, additional e-Specialists, and any number of Market Makers in each class, unless limited by quotation system capacity.<sup>18</sup>

The proposed rules governing Market Maker appointments and obligations generally – including rules concerning evaluation of Market Maker performance, suspension or termination

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<sup>15</sup> See generally proposed Rules 930NY-933NY.

<sup>16</sup> See NYSE Arca Rules 6.43-6.46.

<sup>17</sup> See proposed Rule 920NY (as modified by Amendment No. 1).

<sup>18</sup> The proposed rules provide, however, that the Exchange will not restrict access in any particular option class until the Commission approves objective standards for restricting such access. See proposed Rule 923NY(b).

of Market Maker appointments, and appeal for review of Exchange actions adversely affecting a Market Maker – are closely modeled on similar rules of NYSE Arca.<sup>19</sup>

The Exchange represented that NYSE Alternext US Rule 3(j), which governs the use of material, non-public information, applies to ATP Holders trading on the System. The Exchange also represented that Rule 3(j) requires a Market Maker to maintain information barriers – reasonably designed to prevent the misuse of material, non-public information by such Market Maker – between the Market Maker and any of its affiliates that may act as specialist or market maker in any security underlying the options in which the Market Maker makes a market on the Exchange.<sup>20</sup> The Exchange stated that it believes<sup>20</sup> that requiring information barriers between the Market Maker and its affiliates with respect to transactions in the option and the underlying security is important to reduce the opportunity for unfair trading advantages or misuse of material, non-public information. The Commission believes that the proposed rules relating to the duties and obligations of Market Makers generally, and in particular the rules that govern the use of material, non-public information, are consistent with the Act.<sup>21</sup>

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<sup>19</sup> Regarding Market Maker appointments, see proposed Rule 923NY (based on NYSE Arca Rule 6.35). Regarding Market Maker obligations, see proposed Rule 925NY (based on NYSE Arca Rule 6.37), which outlines such obligations (i) generally, (ii) within a Market Maker's appointed classes, and (iii) outside of a Market Maker's appointed classes. See also proposed Rule 925.1NY (based on NYSE Arca Rule 6.37B); proposed Rule 925.2NY (based on NYSE Arca Rule 6.37C). The proposed rules also provide a mechanism for limiting Market Maker risk during periods of increased and significant trading activity on the System in a Market Maker's appointment. See proposed Rule 928NY. The Exchange would activate the mechanism in a Market Maker's appointed class whenever a designated number of executions (ranging between five and 100 executions) occurs within one second. Orders and quotations received by the Exchange after the mechanism is activated would not be executed against the Market Maker. The proposed rule is similar to NYSE Arca Rule 6.40.

<sup>20</sup> See Amendment No. 1 at 5.

<sup>21</sup> See Securities Exchange Act Release No. 47838 (May 13, 2003), 68 FR 27129, 27137 (May 19, 2003) (SR-PCX-2002-36).

a. FMMs and RMMs

FMMs and RMMs are required to apply and be approved for an appointment in one or more options classes. The number of options issues that an FMM or RMM may select is based on the number of ATPs the FMM or RMM holds.<sup>22</sup> In addition, an FMM is required to select an appointment to a Trading Zone on the floor. FMMs and RMMs are required to provide continuous, two-sided quotes in their appointed issues, in accordance with maximum prescribed width requirements, for 60% of the time the Exchange is open for trading in each issue, and to trade at least 75% of their contract volume per quarter in classes within their appointments.<sup>23</sup> All transactions effected by an FMM in open outcry in the FMM's designated Trading Zone will be considered as transactions towards satisfying the rule requiring that an FMM trade at least 75% of its contract volume per quarter in classes within its appointments.

The Commission believes that the proposed rules governing Market Maker activity on the Exchange are consistent with the Act.<sup>24</sup>

b. Specialists and E-Specialists

The proposed rules include provisions governing the appointment and activities of Specialists, who are assigned a location on the floor where their issues will trade, and e-Specialists, who are RMMs appointed to fulfill certain obligations required of Specialists. Under the proposal, the Exchange is permitted to appoint one Specialist and an unlimited number of other Market Makers per class.<sup>25</sup>

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<sup>22</sup> See proposed Rule 923NY(d).

<sup>23</sup> See proposed Rule 923NY(i).

<sup>24</sup> See supra note 19. See also Securities Exchange Act Release No. 54236 (July 28, 2006), 71 FR 44758 (August 7, 2006) (order approving similar rules on OX, NYSE Arca's automated options trading system) ("OX Approval Order").

<sup>25</sup> See proposed Rule 923NY(b).

Any ATP Holder registered as a Market Maker with the Exchange is eligible to be qualified as a Specialist<sup>26</sup> and may be allocated any one or more of the option issues opened for trading. The allocation of issues among qualified applicants will be determined by the Exchange, which will select the candidate that appears best able to perform the functions of a Specialist in a particular option issue.

Each Specialist will be appointed to the Trading Zone designated for its options classes. A Specialist is required, among other things, to provide continuous two-sided quotations throughout the trading day in its appointed issues for 90% of the time the Exchange is open for trading<sup>27</sup> and otherwise fulfill the obligations of Market Makers generally. A Specialist's quotations must meet the legal quote requirements specified in proposed Rule 925NY.<sup>28</sup>

In addition, the Exchange is permitted to designate e-Specialists in an options class to fulfill certain obligations required of Specialists.<sup>29</sup> Factors to be considered in approving e-Specialists include adequacy of resources; history of stability, superior electronic capacity and superior operational capability; market making and/or specialist experience in a broad array of securities; ability to interact with order flow in all types of markets; existence of order flow commitments; willingness to accept allocation as an e-Specialist in options in at least 400 underlying securities; and willingness and ability to make competitive markets on the Exchange and to promote the Exchange in a manner that is likely to enhance the ability of the Exchange to compete successfully for order flow in the options it trades.

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<sup>26</sup> The provisions regarding Specialists are set forth primarily in proposed Rules 925.1NY(b) and 927-927.3NY.

<sup>27</sup> These obligations will apply to all of the Specialist's appointed issues collectively, rather than on an issue-by-issue basis.

<sup>28</sup> There are exceptions to these quoting requirements for systems failures and limitations and other mitigating circumstances.

<sup>29</sup> See generally proposed Rules 927.4-927.6NY.

Option classes that have been allocated to a Specialist may be concurrently allocated to one or more e-Specialists,<sup>30</sup> with the Exchange to determine the appropriate number.<sup>31</sup> Each e-Specialist will be required to fulfill all the obligations set forth in proposed Rules 925NY and 925.1NY. E-Specialists have the same 90% quoting obligation as Specialists.<sup>32</sup>

The Commission believes that the proposed rules regarding Specialists and e-Specialists raise no novel or significant issues and are substantially similar to rules that it has previously approved for other exchanges.<sup>33</sup> The Exchange has based its proposed rules regarding e-Specialists on rules the Commission has approved for CBOE,<sup>34</sup> and the Commission believes that they are consistent with the Act.

c. Directed Order Market Makers

As discussed in more detail below,<sup>35</sup> the System will permit Order Flow Providers<sup>36</sup> to direct orders to "Directed Order Market Makers." A Directed Order Market Maker, who may be a Specialist or other Market Maker, must provide continuous two-sided quotations throughout

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<sup>30</sup> Each e-Specialist organization is required to maintain a sufficient number of ATPs to include appointments in classes where the organization is acting as an e-Specialist.

<sup>31</sup> The Exchange will grant e-Specialists allocations in option classes based on factors including performance, capacity, performance commitments, efficiency, competitiveness, and operational factors. See proposed Rule 927.4(b).

<sup>32</sup> See proposed Rule 927.5NY(a) (as modified by Amendment No. 1), which specifies that an e-Specialist is required to meet the 90% quoting obligations of Specialists set forth in Rule 925.1NY(b).

<sup>33</sup> See, e.g., NYSE Arca Rules 6.82-6.83 (regarding Lead Market Makers); Securities Exchange Act Release No. 47838 (May 13, 2003), 68 FR 27129 (May 19, 2003) (order approving rules for the PCX Plus options trading platform).

<sup>34</sup> See CBOE Rules 8.92-8.94. See also Securities Exchange Act Release No. 49643 (April 30, 2004), 69 FR 25647 (May 7, 2004) (order approving rules adding the category of e-DPMs to the types of market makers trading on CBOE).

<sup>35</sup> See *infra* Section III.B.1.c.

<sup>36</sup> An Order Flow Provider is defined in proposed Rule 900.2NY(57) to mean any ATP Holder that submits, as agent, orders to the Exchange.

the trading day, meeting legal width requirements,<sup>37</sup> in issues for which it receives Directed Orders for 90% of the time the Exchange is open for trading in each issue.<sup>38</sup>

B. Ranking and Execution of Orders

As noted above, Alternext will trade options on an electronic trading system and in open outcry on the floor.

1. Electronic Trading

a. Display Order Process

The System will display all quotations and non-marketable limit orders (unless an order type indicates otherwise) in the "Display Order Process" of its book, at all price levels on an anonymous basis.<sup>39</sup> Bids and offers, including the displayed portion of Reserve Orders,<sup>40</sup> will be ranked and maintained in the Display Order Process according to account type (e.g., Customer or non-Customer)<sup>41</sup> and the following priority rules:

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<sup>37</sup> See proposed Rule 925NY (as modified by Amendment No. 1).

<sup>38</sup> See proposed Rule 964.1NY (as modified by Amendment No. 1). The above obligations will apply to all of the Directed Order Market Maker's issues collectively for which it receives Directed Orders, rather than on an issue-by-issue basis. Compliance with this obligation will be determined on a monthly basis.

<sup>39</sup> The System also will disseminate consolidated quotations and last-sale information, and such other market information as may be made available from time to time pursuant to agreement between the Exchange and other Market Centers, consistent with the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information.

<sup>40</sup> A "Reserve Order" is defined in proposed Rule 900.3NY(d)(3) as a limit order with a portion of the size displayed and with a reserve portion of the size that is not displayed on the Exchange. Upon entry into the System, a marketable Reserve Order will be executed in whole or in part up to its full size, regardless of the reserve size. See Amendment No. 1 at 3.

<sup>41</sup> An order for the account of a "Customer" – defined in proposed Rule 900.2NY(18) as an individual or organization that is not a broker-dealer – has priority over the bid or offer of a non-Customer at the same price.

The highest bid will have priority over all other bids, and the lowest offer will have priority over all other offers. Bids and offers for Customer accounts, including the displayed portion of Customer Reserve Orders, will have priority over other bids or offers at the same price. If there is more than one highest bid or lowest offer for a Customer account then such bid or offer will be ranked based on time priority.

A bid or offer for the account of a Directed Order Market Maker – discussed below – will have second priority for a Directed Order if the Directed Order Market Maker is eligible to receive a guaranteed participation in such bid or offer.<sup>42</sup> If there is no Directed Order Market Maker guarantee, then bids or offers in the book for the accounts of participants in the Specialist Pool<sup>43</sup> – also discussed below – will have priority if the Specialist Pool is eligible to receive a guaranteed participation in such bids or offers.<sup>44</sup>

Orders and Quotes with Size<sup>45</sup> in the book for the accounts of all other non-Customers have next priority. If there is more than one highest bid or lowest offer for the account of a non-Customer, then such bids or offers will be afforded priority on a "size pro rata" basis and will comprise the "size pro rata pool."

b. Working Orders

In addition to bids and offers that are displayed in the Display Order Process, the System will accept "Contingency Orders" and "Working Orders," which are orders that are contingent

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<sup>42</sup> See proposed Rule 964.1NY.

<sup>43</sup> The "Specialist Pool" is defined in proposed Rule 900.2NY(75) as the aggregated size of the best bid and best offer, in a given series, among the Specialist and e-Specialists that match in price.

<sup>44</sup> See proposed Rule 964.2NY.

<sup>45</sup> The term "Quote with Size" is defined in proposed Rule 900.2NY(65) to mean a quotation to buy or sell a specific number of option contracts at a specific price that a Market Maker has submitted to the System.

upon a condition being satisfied or orders with a conditional or undisplayed price and/or size. Contingency Orders and Working Orders are maintained in the "Working Order File" of the book until eligible for execution and/or display.<sup>46</sup> Such orders include Reserve Orders, Stop Orders,<sup>47</sup> Stop Limit Orders,<sup>48</sup> All-or-None Orders, and Tracking Orders.<sup>49</sup>

After displayed interest at a particular price has been executed, orders in the Working Order File have next priority. However, such orders do not have any priority or standing until they are eligible for execution and/or display.<sup>50</sup> For example, when the displayed portion of a Reserve Order has been fully executed,<sup>51</sup> the display is refreshed from the reserve portion of the order (which had been maintained in the Working Order File) up to the size of the original display with a new time stamp.<sup>52</sup> Stop Orders and Stop Limit Orders are not eligible to execute against incoming orders, and become eligible to execute via the Display Order Process only after the incoming order is executed in full or rests in the book, or the Stop or Stop Limit Order is sent to the Display Order Process at the end of a triggering event.<sup>53</sup>

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<sup>46</sup> See Amendment No. 1 at 3.

<sup>47</sup> A Stop Order is defined as an order that becomes a market order when the market for a particular option contract reaches a specified price ("triggering event"). A Stop Order to buy (sell) becomes a market order when the option contract trades at or above (below) the stop price on the Exchange or another Market Center or when the Exchange bid (offer) is quoted at or above (below) the stop price. See proposed Rule 900.3NY(d)(1).

<sup>48</sup> A Stop Limit Order is defined as an order that becomes a limit order when the market for a particular option contract reaches a specified price. A Stop Limit Order to buy (sell) becomes a Limit Order when the option contract trades at or above (below) the stop price on the Exchange or another Market Center or when the Exchange bid (offer) is quoted at or above (below) the stop price. See proposed Rule 900.3NY(d)(2).

<sup>49</sup> See infra notes 54-58 and accompanying text.

<sup>50</sup> See proposed Rule 964NY(b)(2)(E) (as modified by Amendment No. 1).

<sup>51</sup> See supra note 40.

<sup>52</sup> See proposed Rule 900.3NY(d)(3) (as modified by Amendment No. 1).

<sup>53</sup> See proposed Rule 900.3NY(d)(1) (as modified by Amendment No. 1).

A Tracking Order is defined as an undisplayed limit order that is eligible for execution after the Display Order Process against orders equal to or less than the size of the Tracking Order.<sup>54</sup> A Tracking Order is ranked according to its limit price, but is executable only at a price matching the NBBO. It will not trade through the NBBO. If a Tracking Order is executed but not exhausted, the remaining portion of the order will be canceled, without routing the order to another Market Center<sup>55</sup> or market participant.<sup>56</sup> Tracking Orders have last priority and never become part of the Display Order Process.<sup>57</sup> They have standing only if contra-side interest in the System would otherwise be routed to another market center at the NBBO.<sup>58</sup> Tracking Orders will not execute against incoming Linkage Orders.

The proposed rules provide that, prior to or after submitting an order to the System, an ATP Holder is not permitted to inform another ATP Holder or any other third party of any of the terms of the order.<sup>59</sup> In addition, it will be a violation of Rule 935NY when an ATP Holder

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<sup>54</sup> See proposed Rule 900.3NY(d)(5) (as modified by Amendment No. 1).

<sup>55</sup> A "Market Center" is defined in proposed Rule 900.2NY(36) as a national securities exchange that has qualified for participation in the Options Clearing Corporation ("OCC") pursuant to the provisions of the rules of the OCC.

<sup>56</sup> The Exchange provided two examples: (1) The NBBO market in a series is 2.05-2.15. The Exchange's displayed bid is 2.00, but there is a Tracking Order in the Working Order File bidding 2.10 for 10 contracts. An order is received on the Exchange to sell six contracts at 2.05. This order would be matched against the 2.10-buy Tracking Order at a price of 2.05, matching the NBBO. (2) After the same initial scenario, a second Tracking Order to buy 20 contracts paying 2.05 is placed in the book. An order is received to sell 15 contracts at 2.05. The incoming sell order, being larger in size than the first Tracking Order, cannot be executed against it. The incoming order is therefore matched against the second Tracking Order, and will be executed at 2.05, the NBBO price.

<sup>57</sup> See proposed Rule 964NY(b)(2)(F) (as modified by Amendment No. 1).

<sup>58</sup> As stated by the Exchange, Tracking Orders are intended only to provide liquidity in the event a marketable order would otherwise route to another exchange. See Amendment No. 1 at 7.

<sup>59</sup> See proposed Rule 935NY, Commentary .04 (as added by Amendment No. 1).

enters a Tracking Order for the purpose of executing as principal an order it also represents as agent.<sup>60</sup>

c. Participation Entitlements

The System will include participation guarantees that, when the requisite conditions are fulfilled, will entitle certain participants – Specialists, e-Specialists, and Directed Order Market Makers – to a certain percentage of each incoming order, after Customer Orders are satisfied.

Directed Order Market Makers. The System will permit Specialists and Market Makers to receive "Directed Orders."<sup>61</sup> A Directed Order is a marketable order that has been directed to a particular Market Maker by an Order Flow Provider.<sup>62</sup> If an incoming marketable order is so directed, the Directed Order Market Maker will be entitled to receive 40% (or such lower percentage as may be determined by the Exchange) of the portion of an order remaining after Customer Orders in the book have been satisfied, provided the Directed Order Market Maker is quoting at the NBBO at the time the order is received by the Exchange for at least that size.<sup>63</sup>

To be eligible to receive Directed Orders, a Directed Order Market Maker must provide continuous two-sided quotations throughout the trading day in issues for which it receives Directed Orders for 90% of the time the Exchange is open for trading in each issue.<sup>64</sup>

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<sup>60</sup> See proposed Rule 935NY, Commentary .05 (as added by Amendment No. 1).

<sup>61</sup> See proposed Rule 964.1NY.

<sup>62</sup> See proposed Rule 900.3NY(s).

<sup>63</sup> The Directed Order Market Maker will be allocated a number of contracts equal to the greater of the guaranteed participation or its "size pro rata" allocation, but in either case, no greater than the size of the Directed Order Market Maker's disseminated size.

<sup>64</sup> Such quotations must meet the legal quote width requirements of Rule 925NY. These quoting obligations will apply collectively to all series in all of the issues for which the Directed Order Market Maker receives Directed Orders, rather than on an issue-by-issue basis. Compliance will be determined on a monthly basis. See proposed Rule 964.1NY(iv) (as added by Amendment No. 1).

Specialists and e-Specialists. In the System, the proposed rules permit the Exchange to establish from time to time a participation entitlement for Specialists and e-Specialists, known collectively as the "Specialist Pool." The Specialist Pool participation entitlement will not apply when a Directed Order Market Maker receives a guaranteed participation. To receive a participation entitlement, a Specialist (on the trading floor) or e-Specialist must be quoting at the NBBO and may not be allocated a total quantity greater than the quantity than it is quoting at the NBBO. The Specialist Pool will be entitled to up to 40% of the size of an incoming order (or such lower percentage as may be determined by the Exchange) that remains after all Customer Orders in the book at the best bid or offer have been satisfied.

Within the Specialist Pool participation entitlement, the Specialist and e-Specialists quoting at the NBBO will participate on a size pro rata basis. However, the Specialist's size pro-rata participation in the Specialist Pool will receive additional weighting, as determined by the Exchange and announced via Regulatory Bulletin, but in no case greater than 66 2/3% if there is only one e-Specialist, and no more than 50% if there are two or more e-Specialists.

For all orders of five contracts or fewer, the Specialist Pool will be allocated any balance of the order after any Customer Orders on the book have been satisfied, provided the Specialist Pool is quoting at the NBBO and a Directed Order Market Maker did not receive a guaranteed allocation. These orders of five contracts or fewer, or any balances thereof after Customer Orders in the book have been satisfied, will be allocated to each participant in the Specialist Pool on a rotating basis, provided the recipient Specialist's quoted size is equal to or greater than the size of the allocation.<sup>65</sup>

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<sup>65</sup> Commentary .01 to proposed Rule 964NY provides that, on a quarterly basis, the Exchange will evaluate what percentage of the volume executed on the Exchange is composed of orders for five contracts or fewer that is allocated to the Specialist Pool, and

d. Additional Provisions

If an incoming limit order is not entirely filled after trading against any eligible interest in the Working Order File, the balance of the order will be executed at the next available price level or, if the limit order locks or crosses the NBBO, matched against any available Tracking Order (prior to being routed) or routed to the away market(s) displaying the NBBO.<sup>66</sup> If the above conditions do not apply, and the order is no longer marketable, or if the order has been designated as an order type that is not eligible to be routed away, the order would be placed in the book or, if it would lock or cross the NBBO, canceled.<sup>67</sup>

The proposed rules also include a provision providing that ATP Holders may not execute as principal orders they represent as agent on the System unless (i) agency orders are first exposed on the Exchange for at least three seconds; or (ii) the user has been bidding or offering on the Exchange for at least three seconds prior to receiving an agency order that is executable against such bid or offer.<sup>68</sup>

The Commission believes that the Exchange's proposed priority and allocation rules are consistent with the Act. The Commission has previously approved participation guarantees for

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will reduce the size of the orders included in this entitlement if such percentage is over 40%.

<sup>66</sup> If an incoming market order is not entirely filled after trading against any eligible interest in the Working Order File, the balance of the order will be executed at the next available price level based on split-price execution or, if such order is marketable against the NBBO, the order would be executed against any eligible Tracking Order or routed away. E-mail from Andrew Stevens, Chief Counsel – U.S. Equities & Derivatives, NYSE Euronext, Inc., to Michael Gaw, Assistant Director, Division of Trading and Markets, Commission, on February 26, 2009.

<sup>67</sup> See proposed Rule 964NY(c)(2) (as modified by Amendment No. 1).

<sup>68</sup> See proposed Rule 935NY. The Exchange stated that attempts to use a Tracking Order to execute a cross transaction is considered a violation of Rule 935NY, as that rule requires an order to be exposed (displayed) if it is part of a cross transaction. See Amendment 1 at 7. See also supra note 60 and accompanying text.

Market Makers, to which orders are directed by other exchange members, of up to 40% of the size of such directed orders (after any Customer Orders have been satisfied), provided such Market Maker is quoting at the NBBO when the order is received by the Exchange and meets specified, higher quoting obligations.<sup>69</sup> In its comment letter, CBOE stated that the proposed Directed Order Market Maker program is similar to other options exchanges' programs, but noted that the Alternext proposal, unlike the rules of other exchanges, appeared not to require Directed Order Market Makers to be subject to a heightened quoting requirement to qualify as Directed Order Market Makers. In Amendment No. 1, the Exchange added a provision that establishes such a heightened standard.<sup>70</sup>

The Commission has also previously approved Specialist Pool participations of up to 40% of the size of incoming orders (after any Customer Orders have been satisfied and only when the Directed Order guarantee has not been applied), provided that the Specialist Pool is quoting at the NBBO when the order is received by the Exchange. The Commission believes that these guarantees strike a reasonable balance between rewarding certain participants for making markets (in the case of Specialists and e-Specialists) or bringing liquidity to the exchange (in the case of Directed Order Market Makers), with providing other market participants an incentive to quote aggressively.

The Commission also believes that the proposed rules providing for the allocation of orders of five contracts or fewer to the Specialist Pool are consistent with the Act.<sup>71</sup>

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<sup>69</sup> See Securities Exchange Act Release No. 57844 (May 21, 2008), 73 FR 30988 (May 29, 2008) (directed orders on NASDAQ OMX PHLX). Other exchanges have similar directed order or "preferred market maker" programs. See, e.g., CBOE Rule 8.13; International Securities Exchange ("ISE") Rule 713; current Exchange Rule 997-ANTE.

<sup>70</sup> See proposed Rule 964.1NY(iv) (as added by Amendment No. 1).

<sup>71</sup> Other exchanges have similar rules. See, e.g., ISE Rule 713; NASDAQ OMX PHLX Rule 1014(g).

With regard to Working Orders and their conditions of execution, the Commission has previously approved most of the order types that the Exchange proposes to implement. Although the Commission has not previously approved an order type in the options markets with exactly the same features as the Tracking Order,<sup>72</sup> the Commission also finds the proposed rules relating to Tracking Orders to be consistent with the Act. As set forth in the proposed rules, an incoming order will never be executed against a Tracking Order at a price that is inferior to the NBBO. Thus, an execution against a Tracking Order would never trade through the best price available on another market. An incoming order also will never be executed at a price better than the NBBO. Thus, Tracking Orders do not constitute hidden interest at a better price than the publicly disseminated market.

Tracking Orders are intended only to provide liquidity in the event a marketable order would otherwise route to another exchange. Tracking Orders provide participants on the System the ability to pre-set orders to automatically "step up" to the NBBO to trade against an incoming order when no other interest at that price is available on the Exchange, before the order is routed to another exchange. In this regard, the use of Tracking Orders is similar to automatic step-up features on other exchanges that the Commission has approved.<sup>73</sup>

In its comment letter on the proposed rule change,<sup>74</sup> CBOE expressed its understanding that, because Tracking Orders are not exposed in the System, they should not be eligible for

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<sup>72</sup> Similar orders have previously been approved in the equities markets. See Securities Exchange Act Release No. 53117 (January 13, 2006), 71 FR 3910 (January 24, 2006) (SR-PCX-2005-87).

<sup>73</sup> See, e.g., CBOE Rule 6.8, Interpretations and Policies .02(b).

<sup>74</sup> See supra note 5.

crossing pursuant to proposed Rule 935NY.<sup>75</sup> In Amendment No. 1, the Exchange responded to this comment by adding a new Commentary .05 to proposed Rule 935NY stating explicitly that it will be a violation of Rule 935NY when an ATP Holder enters a Tracking Order for the purpose of executing as principal an order it also represents as agent. The Commission believes that this provision is reasonably designed to prevent use of Tracking Orders to circumvent the general requirement to expose agency orders before executing against them as principal, and is therefore consistent with the Act. The Exchange also added a new Commentary .04 to proposed Rule 935NY to provide that, prior to or after submitting an order to the System, an ATP Holder is not permitted to inform another ATP Holder or any other third party of any of the terms of the order. The Commission believes that this provision is consistent with the Act because it is reasonably designed to prevent ATP Holders from providing material, non-public information to third parties and to promote compliance with the Commission's Quote Rule.<sup>76</sup>

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<sup>75</sup> Proposed Rule 935NY provides that, with respect to orders routed to the System, users may not execute as principal orders they represent as agent unless (i) agency orders are first exposed on the Exchange for at least three seconds or (ii) the user has been bidding or offering on the Exchange for at least three seconds prior to receiving an agency order that is executable against such bid or offer.

<sup>76</sup> 17 CFR 242.602. The Quote Rule, in relevant part, requires a national securities exchange to collect, process, and make available to vendors the best bid, the best offer, and aggregate quotation sizes for each subject security that is communicated on any national securities exchange by a responsible broker or dealer. A "bid" or "offer" is defined as "the bid price or the offer price communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer..." 17 CFR 242.600(b)(8). Because Tracking Orders and the non-displayed size of Reserve Orders are sent only to the Exchange systems and not "communicated . . . to any broker, dealer, or customer," such orders are not "bids" or "offers." Thus, the Quote Rule does not require the Exchange to disseminate information about Tracking Orders and the non-displayed size of Reserve Orders. However, if an ATP Holder were to inform a third party of the terms of a Tracking Order or the non-displayed size of a Reserve Order, such Orders would become "bids" or "offers" subject to the Quote Rule.

CBOE also argued that, prior to effecting any transactions in open outcry, Exchange members should be required to electronically "sweep" the book for any Tracking Order interest in the System, so as not to violate the priority of such orders. CBOE pointed to rules at other exchanges that require members seeking to trade in open outcry to electronically sweep the book for any penny interest from "penny price improvement orders"<sup>77</sup> before executing an order. The Exchange responded that a Tracking Order does not have any standing with regard to open-outcry trading, as it is not displayed and, unlike price-improving orders and quotations, is not represented by a displayed bid or offer at an indicative price. The Commission agrees with the distinction made by the Exchange. As set forth in the proposed rules, a Tracking Order has standing only if contra-side interest in the System would otherwise be routed to another market center at the NBBO.<sup>78</sup> The Commission also notes that Tracking Orders can be entered in the System only at standard trading increments, and thus cannot be used to gain priority over displayed interest by a sub-increment amount.

CBOE further questioned the proposed provision that, when a Tracking Order in the System is at a better price than another Tracking Order, but cannot be executed due to insufficient size, it does not have priority. CBOE also questioned in general why an incoming order does not trade against a Tracking Order at a price better than the NBBO when the Tracking Order is submitted at such a price. In Amendment No. 1, the Exchange responded that the order handling instruction on a Tracking Order is that it is to be executed only at a price that matches the NBBO on the same side of the market, and only against lesser or equal-sized contra-side

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<sup>77</sup> "Penny price improvement" rules permit members of an exchange to submit bids and offers that provide price improvement in one-cent increments that are not displayed in the book, in options in which the standard increment is more than one-cent. Such bids and offers are displayed by rounding to the nearest standard increment.

<sup>78</sup> See proposed Rule 900.3NY(d)(5).

interest. The limit price on a Tracking Order serves only to provide a boundary on the order's possible execution price and to establish its ranking. The Commission believes that the Exchange's response adequately addresses CBOE's question, and that it is consistent with the Act for the Exchange to offer an order type with these conditions.

e. Open-Outcry Trading

Proposed Rule 963NY describes priority and order allocation for open-outcry trading, including procedures to be followed when there is interest at the same price in the book as on the trading floor. The proposed rules governing open-outcry trading on the Exchange floor are similar to those at other exchanges with trading floors, and the Commission finds that they are consistent with the Act.

When a Floor Broker or Market Maker makes a bid or offer or calls for a market and more than one ATP Holder responds at the same best price, the Floor Broker or Market Maker must designate the sequence in which responses are vocalized. As between two bids or offers at the same best price, priority is afforded in the sequence they are made.<sup>79</sup> If they were made simultaneously or it is impossible to determine clearly the order in which they were made, such orders would be deemed to be on parity, and priority will be afforded, insofar as practicable, on an equal basis. However, a Customer Order displayed in the book at the same price as the best price in the crowd will have priority over any bid or offer at the post. After any Customer Orders displayed in the book at the best bid or offer in the crowd are satisfied, the Specialist is entitled to trade with 40% of the order, provided the Specialist has vocally responded to the Floor Broker's call for a market and has responded with a price that is the best bid or offer. Bids and

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<sup>79</sup> Thus, for example, the bid or offer of a non-Customer in the trading crowd that was made before that of a Customer represented by a Floor Broker in the trading crowd would take priority over the Customer Order (provided the requirements of Section 11(a) of the Act and the rules thereunder are met).

offers of broker-dealers (including Quotes with Size and orders of Market Makers displayed on the book) would have priority after all trading crowd interest is exhausted.

Customer-to-Customer Crosses. The proposed rules include procedures by which a Floor Broker who holds a Customer Order to buy and a Customer Order to sell may cross such orders on the floor.<sup>80</sup> After providing an opportunity for bids and offers to be made by members of the trading crowd, the Floor Broker must bid above the highest bid in the crowd and offer below the lowest offer in the crowd. After satisfying all better priced bids or offers on the book and any Customer Orders on the book at the same price, the Floor Broker is permitted to cross the orders at such higher bid or lower offer by announcing by open outcry that he is crossing orders on behalf of Customers, and giving the quantity and price. The Floor Broker is permitted to cross the orders at split prices if the rules governing split price transactions are met.<sup>81</sup>

Non-Facilitation (Regular Way) Crosses. The proposed rules also include procedures by which a Floor Broker who holds a Customer Order and a non-Customer order may cross such orders.<sup>82</sup> After providing an opportunity for bids and offers to be made by members of the trading crowd, the Floor Broker must expose the Customer Order by bidding above the highest bid in the crowd or offering below the lowest offer in the crowd, by at least one minimum price variation ("MPV"). After satisfying all better priced bids or offers on the book, any Customer Orders on the book at the same price, and any interest by members of the trading crowd at such higher bid or lower offer, the Floor Broker is permitted to cross the orders (or any part remaining unexecuted) at such higher bid or lower offer by announcing by open outcry that he is crossing the orders, and giving the quantity and price.

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<sup>80</sup> See proposed Rule 934NY(a).

<sup>81</sup> See proposed Rule 963NY(f).

<sup>82</sup> See proposed Rule 934NY(b).

Facilitation Crosses. The proposed rules further include procedures by which a Floor Broker who holds a Customer Order and a Facilitation Order may cross such orders.<sup>83</sup> After providing an opportunity for bids and offers to be made by crowd members, the Floor Broker, on behalf of the Customer whose order is subject to facilitation, must disclose any contingencies with respect to the order, identify the order as being subject to facilitation, and establish priority by either bidding or offering at or between the best bid or offer in the market. After all other crowd members are given an opportunity to accept the bid or offer made on behalf of the Customer, the Floor Broker is permitted to cross all or any remaining part of such order and the Facilitation Order at the price of the Customer's bid or offer by announcing by open outcry that he is crossing such orders, and stating the quantity and price.

Notwithstanding the above, if the proposed cross transaction meets the eligible size requirement of 50 contracts or larger, a Facilitation Order can trade with up to 40% of the Customer Order, after satisfying all better-priced bids or offers on the book or in the trading crowd and any Customer Orders at the same price.<sup>84</sup>

"At-Risk" Crosses. The proposed rules establish an alternative to the Facilitation Cross procedures for a Floor Broker that seeks to cross a Customer Order with an order from the ATP

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<sup>83</sup> See proposed Rule 934.1NY. A "Facilitation Order" is an order represented on behalf of an ATP Holder that may be executed in whole or in part in a cross transaction with the ATP Holder's Customer Order and that is clearly designated as a Facilitation Order.

<sup>84</sup> If a trade pursuant to proposed Rule 934.1NY occurs at the Specialist's vocalized bid or offer in its appointed class, the Specialist's guaranteed participation will apply only to the number of contracts remaining after all Customer Orders that trade ahead of the cross transaction and the number of contracts crossed have been satisfied. The Specialist's guaranteed participation will be a percentage that, when combined with the percentage the originating firm crossed, does not exceed 40% of the order. See proposed Rule 934.1NY(4)(C).

Holder from which the Customer Order originated.<sup>85</sup> After providing an opportunity for bids and offers to be made by members of the trading crowd, the Floor Broker must represent the Customer Order to the trading crowd, indicating that it is a Customer Order and providing the order's size, side of the market, and a price. After giving the trading crowd an opportunity to improve its quote, the Floor Broker may improve the crowd's market on behalf of the ATP Holder to one MPV away from the Customer Order and thereby establish priority over the crowd at this new price. The crowd may trade with the Customer Order at that order's price, or trade with the ATP Holder's order at its proposed price. To the extent the crowd does not trade with the Customer Order, the Floor Broker may effect the cross.

The Commission finds that the Exchange's proposed crossing rules are consistent with the Act. They are similar to other crossing rules that the Commission has previously approved for Amex and other exchanges<sup>86</sup> and do not appear to raise any novel or significant issues.

Solicited Orders. The proposed rules include procedures by which a Floor Broker representing an order ("originating order") may cross it with an order solicited from another ATP Holder or non-member broker-dealer outside the trading crowd ("solicited party").<sup>87</sup> The Floor Broker must announce to the trading crowd the same terms and conditions about the originating order as disclosed to the solicited party. The Floor Broker would also announce the price at which he is prepared to buy from or sell to the solicited party. After all other market participants are given a reasonable opportunity to accept the bid or offer, the solicited party may trade with any remaining part of the originating order.

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<sup>85</sup> The proposed rule for At-Risk Crosses applies only to equity options. The minimum eligible order size for an At-Risk Cross is 50 contracts. See proposed Rule 934.2NY.

<sup>86</sup> See, e.g., Amex Rule 950-ANTE(d), Commentaries .02-.04; CBOE Rule 6.74; NYSE Arca Rule 6.47.

<sup>87</sup> See proposed Rule 934.3NY.

Generally, non-solicited market participants and Floor Brokers holding non-solicited discretionary orders in the crowd have priority over the solicited party or the solicited order to trade with the original order at the best bid or offer price. However, if the solicited order improved the crowd's quoted market, the Floor Broker would be permitted to cross the solicited order against the Customer Order to the extent of 40% of the contracts remaining after any Customer Orders have been filled. The eligible order size for this guarantee to apply is a minimum of 50 contracts.<sup>88</sup>

The Exchange's proposed rules for solicited orders, which are similar to rules the Commission has previously approved,<sup>89</sup> do not appear to raise any novel or substantive issues, and the Commission believes they are consistent with the Act.

#### C. Section 11(a) Compliance

Section 11(a)(1) of the Act<sup>90</sup> prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion (each, a "covered account," and collectively, "covered accounts"), unless an exemption applies. Sections 11(a)(1)(A)-(I) of the Act<sup>91</sup> and the rules thereunder provide certain exemptions from the general prohibition, including the exemptions set forth in Rules 11a2-2(T) and 11a1-1(T) under the Act.<sup>92</sup>

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<sup>88</sup> See proposed Rule 934.3 (as modified by Amendment No. 1).

<sup>89</sup> See, e.g., Amex Rule 950-ANTE(d), Commentaries .02 and .04.

<sup>90</sup> 15 U.S.C. 78k(a)(1).

<sup>91</sup> 15 U.S.C. 78k(a)(1)(A)-(I).

<sup>92</sup> 17 CFR 240.11a2-2(T) and 240.11a1-1(T).

With respect to the general prohibition and exemptions of Section 11(a)(1) and the rules thereunder, the Exchange proposes to adopt new Rule 910NY. The proposed rule states that an ATP Holder must ensure that each of its transactions complies with Section 11(a) of the Act, which generally prohibits an ATP Holder from effecting a transaction trading for a covered account unless a valid exemption in the statute or the rules thereunder applies. The proposed rule further states that, when relying on the exemption set forth in Rule 11a2-2(T) under the Act, a Floor Broker may not enter into the System any order for a covered account, including an order sent to it by an affiliated ATP Holder from off the floor, if the order is for such affiliated ATP Holder's own account, the account of an associated person, or an account over which it or its associated person exercises discretion. In addition, the proposed rule provides that, in cases where a Floor Broker's transaction would occur at the same price as one or more orders on the book, the Floor Broker, if it can rely on no exception other than the exemption in Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder (as discussed in more detail below) must, in addition to complying with the other requirements of such exemption, yield to all orders in the book at the same price if the Floor Broker has no ability to determine that an order in the book is not the order of a non-ATP Holder. Proposed Rule 910NY also states that, where an ATP Holder submits an order to the book (or an order is submitted on its behalf) and such ATP Holder is relying on the G Exemption, the order must be entered as immediate-or-cancel.

The Exchange has represented that it has analyzed its rules proposed hereunder, which include proposed Rule 910NY, and has determined that they are consistent with Section 11(a) of the Act and rules thereunder.<sup>93</sup> For the reasons set forth below, the Commission believes that the

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<sup>93</sup> See Amendment No. 1 at 7.

proposed rules are consistent with the requirements of Section 11(a) of the Act and the rules thereunder.

1. Rule 11a2-2(T)

Rule 11a2-2(T) under the Act,<sup>94</sup> known as the "effect versus execute" rule, provides exchange members with an exemption from the Section 11(a)(1) prohibition. Rule 11a2-2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with the conditions of Rule 11a2-2(T), a member: (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;<sup>95</sup> (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the rule. The Exchange has requested that the Commission concur with its conclusion that orders for covered accounts entered into the System satisfy the conditions of Rule 11a2-2(T). Rule 11a2-2(T)'s first condition is that orders for covered accounts be transmitted from off the exchange floor. The Exchange represents that orders sent to the System will be transmitted from remote terminals directly to the System by electronic means. In the context of other automated trading systems, the Commission has found that the off-floor transmission requirement is met if a covered account order is transmitted from a remote location directly to an exchange's floor by electronic means.<sup>96</sup>

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<sup>94</sup> 17 CFR 240.11a2-2(T).

<sup>95</sup> The member may, however, participate in clearing and settling the transaction.

<sup>96</sup> See, e.g., Securities Exchange Act Release Nos. 59154 (December 23, 2008), 73 FR 80468 (December 31, 2008) (SR-BSE-2008-48) (approving, among other things, the equity rules of the Boston Stock Exchange ("BSE")); 57478 (March 12, 2008), 73 FR

With respect to such orders transmitted electronically from remote terminals directly to the System, the Commission believes that the System satisfies the off-floor transmission requirement.

The Exchange further represents that there may be instances where an ATP Holder on the physical floor of the Exchange may electronically submit an order for a covered account to the System. The Exchange states that, to rely on the exemption set forth in Rule 11a2-2(T), an ATP Holder must ensure that it sends its orders from off the floor to an unaffiliated ATP Holder on the floor for execution, in addition to meeting the rule's other requirements. If an ATP Holder sends its order from off the floor to an affiliated member that is on the floor, who then directs the order into the System for execution, the off-floor ATP Holder may not rely on the exemption set forth in Rule 11a2-2(T). The Commission believes that, based on the foregoing, those orders for covered accounts sent by ATP Holders to the System for execution from off the Exchange floor satisfy the off-floor transmission requirement for the purposes of the "effect versus execute" rule. The Commission notes that an ATP Holder that submits an order for a covered account for execution on the physical floor of the Exchange and who wishes to rely on the exemption in Rule 11a2-2(T) also must submit the order from off the floor.

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14521 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080) (approving rules governing the trading of options on The NASDAQ Options Market); 49068 (January 13, 2004), 69 FR 2775 (January 20, 2004) (SR-BSE-2002-15) (approving the Boston Options Exchange as an options trading facility of BSE); 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979) (approving the Amex Post Execution Reporting System, the Amex Switching System, the Intermarket Trading System, the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange, the PCX Communications and Execution System, and the Philadelphia Stock Exchange Automated Communications and Execution System) ("1979 Release"); and 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978) (approving NYSE's Designated Order Turnaround System) ("1978 Release").

Second, Rule 11a2-2(T) requires that the member not participate in the execution of its order once the order is transmitted to the floor for execution. The Exchange represents that, upon submission to the System, an order will enter the queue and be executed against another order or quote in the book based on an established matching algorithm. The Exchange states that execution depends not on whether an order is for the account of an ATP Holder, but rather upon what other orders are entered into the System at or around the same time as the subject order, what orders are resident in the book, and where the order is ranked based on, among other criteria, a price-time priority ranking algorithm. As such, the Exchange represents that at no time following the submission of an order to the System is an ATP Holder able to acquire control or influence over the result or timing of an order's execution.<sup>97</sup> Accordingly, the Commission believes that an Exchange member does not participate in the execution of an order submitted into the System. The Commission notes that an ATP Holder that submits an order for a covered account for execution on the physical floor of the Exchange and that wishes to rely on the exemption in Rule 11a2-2(T) is similarly restricted from participating in the execution of such order after the order has been transmitted to the System.

Third, Rule 11a2-2(T) requires that the order be executed by an exchange member who is unaffiliated with the member initiating the order. The Commission has stated that the requirement is satisfied when automated exchange facilities, such as the System, are used, as

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<sup>97</sup> See Amendment No. 1 at 9. The Commission notes that an ATP Holder may cancel or modify the order, or modify the instructions for executing the order. The Commission has stated that the non-participation requirement is satisfied under such circumstances so long as such modifications or cancellations are also transmitted from off the floor. See 1978 Release, *id.* (stating that the "non-participation requirement does not prevent initiating members from canceling or modifying orders (or the instructions pursuant to which the initiating member wishes orders to be executed) after the orders have been transmitted to the executing member, provided that any such instructions are also transmitted from off the floor").

long as the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the Exchange.<sup>98</sup> The Exchange has represented that the design of the System ensures that ATP Holders do not have any special or unique trading advantages in the handling of their orders after transmission.<sup>99</sup> Based on the Exchange's representations, the Commission believes that the System satisfies this requirement. The Commission notes that, if an ATP Holder submits an order for a covered account for execution on the physical floor of the Exchange, to comply with this requirement of Rule 11a2-2(T), such order would have to be sent to an unaffiliated ATP Holder on the Exchange floor.

Fourth, in the case of a transaction effected for an account with respect to which the initiating member or an associated person thereof exercises investment discretion, neither the initiating member nor any associated person thereof may retain any compensation in connection with effecting the transaction, unless the person authorized to transact business for the account has expressly provided otherwise by written contract referring to Section 11(a) of the Act and Rule 11a2-2(T).<sup>100</sup> The Exchange recognizes that ATP Holders trading for covered accounts

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<sup>98</sup> In considering the operation of automated execution systems operated by an exchange, the Commission noted that while there is no independent executing exchange member, the execution of an order is automatic once it has been transmitted into the systems. Because the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T). See 1979 Release, supra note 96.

<sup>99</sup> See Amendment No. 1 at 9.

<sup>100</sup> 17 CFR 240.11a2-2(T)(a)(2)(iv). In addition, Rule 11a2-2(T)(d) requires a member or associated person authorized by written contract to retain compensation, in connection with effecting transactions for covered accounts over which such member or associated person thereof exercises investment discretion, to furnish at least annually to the person authorized to transact business for the account a statement setting forth the total amount of compensation retained by the member in connection with effecting transactions for the

over which they exercise investment discretion must comply with this condition to rely on the rule's exemption.<sup>101</sup> The Exchange represents that it will enforce this requirement pursuant to its obligation under Section 6(b)(1) of the Act to enforce compliance with the federal securities laws.<sup>102</sup>

## 2. Section 11(a)(1)(G) and Rule 11a1-1(T)

Section 11(a)(1)(G) of the Act provides an additional exemption from the general prohibition set forth in Section 11(a)(1) for any transaction for a member's own account, provided that: (i) such member is primarily engaged in certain underwriting, distribution, and other activities generally associated with broker-dealers and whose gross income is derived principally from such business and related activities; and (ii) the transaction is effected in compliance with the rules of the Commission, which, as a minimum, assure that the transaction is not inconsistent with the maintenance of fair and orderly markets and yields priority, parity, and precedence in execution to orders for the account of persons who are not members or associated with members of the exchange.<sup>103</sup> In addition, Rule 11a1-1(T) under the Act specifies that a transaction effected on a national securities exchange for the account of a member which meets the requirements of Section 11(a)(1)(G)(i) of the Act is deemed, in accordance with the requirements of Section 11(a)(1)(G)(ii), to be not inconsistent with the maintenance of fair and orderly markets and to yield priority, parity, and precedence in execution to orders for the

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account during the period covered by the statement. See 17 CFR 240.11a2-2(T)(d). See also 1978 Release, supra note 96 (stating "[t]he contractual and disclosure requirements are designed to assure that accounts electing to permit transaction-related compensation do so only after deciding that such arrangements are suitable to their interests").

<sup>101</sup> See Amendment No. 1 at 10.

<sup>102</sup> See id.

<sup>103</sup> See 15 U.S.C. 78k(a)(1)(G).

account of non-members or persons associated with non-members of the exchange, if such transaction is effected in compliance with certain requirements.<sup>104</sup>

Proposed Rule 910NY provides that, in cases where the transaction of an ATP Holder on the physical floor would occur at the same price as one or more orders on the book and where such ATP Holder can rely on no exemption other than the exemption set forth in Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder, such ATP Holder must, in addition to complying with the other requirements of Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder, yield to all orders in the book at the same price, if such ATP Holder cannot determine that an order in the book is not the order of a non-ATP Holder.<sup>105</sup> The Exchange represents that, in such cases, if an ATP Holder seeks to rely on the exemption set forth in Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder for the execution of an order for its own account, such order may be executed only on the physical floor of the Exchange or must

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<sup>104</sup> Rule 11a1-1(T)(a)(1)-(3) provides that each of the following requirements must be met: (1) A member must disclose that a bid or offer for its account is for its account to any member with whom such bid or offer is placed or to whom it is communicated, and any member through whom that bid or offer is communicated must disclose to others participating in effecting the order that it is for the account of a member; (2) immediately before executing the order, a member (other than the specialist in such security) presenting any order for the account of a member on the exchange must clearly announce or otherwise indicate to the specialist and to other members then present for the trading in such security on the exchange that he is presenting an order for the account of a member; and (3) notwithstanding rules of priority, parity, and precedence otherwise applicable, any member presenting for execution a bid or offer for its own account or for the account of another member must grant priority to any bid or offer at the same price for the account of a person who is not, or is not associated with, a member, irrespective of the size of any such bid or offer or the time when entered. See 17 CFR 240.11a1-1(T)(a)(1)-(3).

<sup>105</sup> See proposed Rule 910NY.

be entered into the System as an IOC order.<sup>106</sup> The Commission notes that this exemption is available only for orders for the account of an Exchange member.<sup>107</sup>

D. Complex Orders

The proposed rules also include provisions governing transactions in Complex Orders, which are defined as orders involving the simultaneous purchase and/or sale of two or more different option series having the same underlying security, for the same account, in a ratio that is equal to or greater than one-to-three (0.333) and less than or equal to three-to-one (3.00), and for the purpose of executing a particular investment strategy.<sup>108</sup> These proposed rules are similar to those the Commission has previously approved for NYSE Arca,<sup>109</sup> and raise no novel or significant issues. The Commission finds that they are consistent with the Act.

The proposed rules also include provisions regarding transactions in NDX or RUT Combination Orders<sup>110</sup> that are virtually identical to current Amex rules governing such transactions that the Commission previously approved.<sup>111</sup> The Commission expects the Exchange to monitor compliance with the requirement in these proposed rules that, at time of the execution of an NDX or RUT combination order, no individual leg of the order trades ahead of the corresponding bid or offer in the NDX or RUT limit order book.

E. Trading Auctions and Trading Halts

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<sup>106</sup> See Amendment No. 1 at 10.

<sup>107</sup> See supra notes 103-104 and accompanying text.

<sup>108</sup> See proposed Rule 900.3NY(e).

<sup>109</sup> See proposed Rule 963NY(d) (based on NYSE Arca Rule 6.75(e); proposed Rule 963.1NY (based on NYSE Arca Rule 6.75, Commentary 0.1, and NYSE Arca Rule 6.91, Commentaries .01 and .02).

<sup>110</sup> See proposed Rule 965NY(b).

<sup>111</sup> See Securities Exchange Act Release No. 57384 (February 26, 2008), 73 FR 11688 (March 4, 2008).

The proposed rules on trading auctions and on procedures for halting or suspending trading are closely modeled on similar rules of NYSE Arca that have been previously approved by the Commission,<sup>112</sup> and the Commission believes they are consistent with the Act.

F. Linkage and Routing

The proposed rules relating to the intermarket options linkage ("Linkage") operated pursuant to the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage are closely modeled on similar rules of NYSE Arca, which previously have been approved by Commission.<sup>113</sup> In addition, existing NYSE Alternext Rule 940 (Options Intermarket Linkage) will continue to apply. The proposed rules relating to a routing broker also are consistent with similar rules of NYSE Arca, which previously have been approved by the Commission.<sup>114</sup>

If an incoming marketable order has not been executed in its entirety on the Exchange and has been designated as an order type that is eligible to be routed away, the order would be routed, either in its entirety or as component orders, for execution to other Market Center(s) displaying the NBBO, either through the Linkage or through a broker-dealer affiliate of the Exchange that acts as an agent for routing orders entered into the System ("Routing Broker"),<sup>115</sup> according to a proprietary algorithm and subject to Exchange rules. Where an order or portion of an order is routed away and is not executed either in whole or in part at the other Market Center, the order upon its return would be ranked and displayed in the book in accordance with its

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<sup>112</sup> See proposed Rules 952NY and 953NY (based on NYSE Arca Rules 6.64 and 6.65 respectively).

<sup>113</sup> See proposed Rules 990NY-993NY (based on NYSE Arca Rules 6.93-6.96).

<sup>114</sup> See proposed Rule 923NY (based on NYSE Arca Rule 6.35); proposed Rule 964NY(c) (consistent with NYSE Arca Rule 6.76A).

<sup>115</sup> In a separate filing, the Exchange has proposed to use Archipelago Securities LLC as its Routing Broker and described the relationship between the Exchange and the Routing Broker and the conditions related to its operation. The Commission is approving that proposal in a separate action today. See supra note 9.

terms.<sup>116</sup> The Exchange's proposed Linkage and routing rules do not raise any novel or substantive issues, and the Commission finds them to be consistent with the Act.

G. Disciplinary Proceedings

Existing Alternext Rules 475, 476, and 477 will continue to govern the Exchange's disciplinary proceedings related to the options trading. Alternext Rule 476A (Imposition of Fines for Minor Violation(s) of Rules) will continue to govern imposition of fines. The Exchange proposes to amend Rule 476A to include options rule violations and their applicable fines that will be in effect after the Options Relocation.

The Commission finds that the disciplinary procedures, as applied to the options trading on the Exchange, are consistent with the Act, in particular Sections 6(b)(6) and 6(b)(7) of the Act.<sup>117</sup> The Commission believes that Rules 475, 476, and 477, as applied to the trading of options on the Exchange, will continue to provide due process for ATP Holders involved in any disciplinary proceeding. The Commission, therefore, believes that these rules will continue to provide the Exchange with the ability to comply, and with the authority to enforce compliance by its members and persons associated with its members, with the provisions of the Act, the rules and regulations thereunder, and the rules of the Exchange, consistent with Section 6(b)(1) of the Act.<sup>118</sup> In addition, because Rule 476A as revised by this filing provides procedural rights to contest the fine and permits disciplinary proceedings on the matter, the Commission believes that this rule provides a fair procedure for the disciplining of ATP Holders and persons associated with ATP Holders, consistent with Sections 6(b)(7) and 6(d)(1) of the Act.<sup>119</sup>

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<sup>116</sup> See proposed Rule 964NY(c)(2)(E). See also supra note 66 and accompanying text.

<sup>117</sup> 15 U.S.C. 78f(b)(6) and 78f(b)(7).

<sup>118</sup> 15 U.S.C. 78f(b)(1).

<sup>119</sup> 15 U.S.C. 78f(b)(7) and 78f(d)(1).

Finally, the Commission finds that the proposed changes to Rule 476A are consistent with the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Act, as required by Rule 19d-1(c)(2) under the Act,<sup>120</sup> which governs minor rule violation plans. The Commission believes that Rule 476A will strengthen the Exchange's ability to carry out its oversight and enforcement responsibilities as a self-regulatory organization in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation.

H. Amendment No. 1 and Accelerated Approval

In Amendment No. 1, the Exchange made certain revisions to the proposed rule text and corresponding changes to the Purpose Section of its Form 19b-4 describing the proposed rule change. In particular, Amendment No. 1:

- Revised the definition of Reserve Order in proposed Rule 900.3NY(d)(3) to clarify how the displayed portion of a Reserve Order is refreshed from the reserve size, and to add that, upon entry into the System, a marketable Reserve Order will be executed in whole or in part up to its full size, regardless of the reserve size;
- Eliminated Stock Contingency Orders from the proposed rule change;
- Revised the definitions of certain Contingency Orders and clarified how such orders are held and processed by the System;
- Revised the definition of Tracking Order in proposed Rule 900.3NY(d)(5) to clarify the function of such orders, prohibit an ATP Holder from informing third parties of any terms of such orders, and provide that it is a violation of Rule

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<sup>120</sup> 17 CFR 240.19d-1(c)(2).

935NY for an ATP Holder to enter a Tracking Order for purposes of executing as principal an order it also represents as agent;

- Revised proposed Rule 902NY concerning an ATP Holder's conduct on the Options Trading Floor to add restrictions on possession of NYSE Floor Broker Hand Held Terminals while on the Options Trading Floor;
- Revised the definition of Market Maker to clarify, among other things, that the definition applies to an e-Specialist;
- Revised proposed Rule 934.3NY to add that the eligible order size for the 40% guaranteed participation for solicited orders will be not less than 50 contracts;
- Clarified procedures for routing orders to away market centers and for handling the routed orders that are not executed and are returned to the book;
- Eliminated references to Exchange Official from Rule 970NY as that term is now obsolete;
- Clarified the quoting obligations of a Directed Order Market Maker to state it must provide continuous two-sided quotations throughout the trading day in issues for which it receives Directed Orders for 90% of the time the Exchange is open for trading in each issue;
- Added a new proposed Rule 910NY, which obligates all ATP Holders to ensure that each of their transactions complies with Section 11(a) of the Act;
- Clarified that existing Exchange rules relating to the trading of FLEX Options would continue to apply; and
- Corrected the list of existing Exchange rules that would be superseded by new rules proposed in this filing.

In addition to making certain revisions to the proposed rule text as described above, in Amendment No. 1 the Exchange also made certain representations:

- The Exchange represented that NYSE Alternext US Rule 3(j), which governs the use of material, non-public information, applies to ATP Holders trading on the System. The Exchange also represented that Rule 3(j) requires a Market Maker to maintain information barriers—reasonably designed to prevent the misuse of material, non-public information by such Market Maker—between the Market Maker and any of its affiliates that may act as specialist or market maker in any security underlying the options in which the Market Maker makes a market on the Exchange; and
- The Exchange represented that it had analyzed its rules proposed hereunder, which include proposed Rule 910NY, and had determined that they are consistent with Section 11(a) of the Act and rules thereunder.

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,<sup>121</sup> for approving the proposal, as modified by Amendment No. 1, prior to the thirtieth day after the date of publication of notice of filing of Amendment No. 1 in the Federal Register. The changes made by Amendment No. 1 are designed to clarify the proposed rules and do not raise any novel or substantive issues. The proposal has otherwise been subject to a full comment period. Therefore, the Commission believes that good cause exists to approve the amended proposal on an accelerated basis.

#### IV. Solicitation of Comments

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<sup>121</sup> 15 U.S.C. 78s(b)(2).

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the filing, as modified by Amendment No. 1, 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](mailto:rule-comments@sec.gov). Please include File Number SR-NYSEALTR-2008-14 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-NYSEALTR-2008-14. 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 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

available publicly. All submissions should refer to File Number SR-NYSEALTR-2008-14 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-NYSEALTR-2008-14), as amended, be, and hereby is, approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>122</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>122</sup> 17 CFR 200.30-3(a)(12).