

# SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-53995; File No. SR-NYSEArca-2006-13)

June 15, 2006

## **Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing of Proposed Rule Change and Amendments No. 1 and 2 Thereto Establishing the OX Trading Platform**

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> notice is hereby given that on May 2, 2006, NYSE Arca, Inc. (“NYSE Arca” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange filed Amendments No. 1<sup>3</sup> and 2<sup>4</sup> to the proposed rule change on June 6, 2006 and June 15, 2006, respectively. The Commission is publishing this notice, as amended, 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**

NYSE Arca proposes to amend its rules governing the trading of listed options on NYSE Arca. With this filing, the Exchange proposes to adopt new rules for the implementation of a new trading platform for options, OX.

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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> Amendment No. 1, which replaced and superseded the original filing in its entirety, is incorporated in this notice.

<sup>4</sup> Amendment No. 2 clarified the circumstances under which orders received by OX would be routed away using Linkage or Archipelago Securities. Amendment No. 2 also made minor changes to the proposed rule text. Amendment No. 2 is incorporated in this notice.

The text of the proposed rule change is available on the Exchange's Web site at <http://www.archipelago.com>, at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

**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

A. Summary and Purpose of the Rule Changes Related to the Implementation of OX

NYSE Arca proposes to establish rules for OX, a fully automated trading system for standardized equity options intended to replace NYSE Arca's current options trading platform, PCX Plus.<sup>5</sup> OX would provide automatic order execution capabilities in the options securities listed and traded on NYSE Arca. Market Makers would be able to stream quotes to OX from on the trading floor or remotely.

1. Description of OX

a. Access. OX would be available for the entry and execution of

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<sup>5</sup> See NYSE Arca Rule 6.90.

quotes and orders to OTP Holders,<sup>6</sup> OTP Firms<sup>7</sup> and, through Sponsoring OTP Firms,<sup>8</sup> certain non-OTP Firms and Holders, such as institutional investors (collectively, “Users”).

b. Method of Operation. In general, Users would be able to enter market orders, marketable limit orders and limit orders. Only Market Makers would be permitted to enter quotes on OX. As Users enter bids and offers (i.e., orders and quotes) into the system, any non-marketable limit orders and quotes would be ranked in an electronic limit order file (the “OX Book”) according to price-time priority, such that within each price level, all bids and offers are organized by the time of entry. The OX Book (except for certain working orders with conditional prices or sizes) would be displayed to all Users. For market orders or marketable limit orders, like-priced bids and offers would be matched by OX for execution at prices equal to or better than the NBBO pursuant to the following algorithm, which is based on price-time priority:

Step 1: All market orders and marketable limit orders would be matched against the displayed top of the OX Book.

Step 2: If an order has not been executed in its entirety pursuant to Step 1, then OX would match the order against any working orders, which are orders with a conditional or undisplayed price and/or size. For example, a reserve order, an order with a portion of the size displayed and reserve portion of the size that is not displayed, is a working order.

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<sup>6</sup> See NYSE Arca Rule 1.1(q).

<sup>7</sup> See NYSE Arca Rule 1.1(r).

<sup>8</sup> See proposed NYSE Arca Rule 6.1A(a)(17).

Step 3: If an order has not been executed in its entirety pursuant to Steps 1 and 2, the order would be routed to another Market Center<sup>9</sup> for execution, unless the User has indicated that the order must not be routed to another market (i.e., by designating an order as a “post no preference” or “PNP” order). If an order that is routed to another market is not executed in its entirety, the order would be ranked and displayed in the OX Book in accordance with the terms of such order pursuant to proposed NYSE Arca Rule 6.76A and such order would be eligible for execution pursuant to proposed NYSE Arca Rule 6.76B.

2. Market Maker Participation. OTP Holders and OTP Firms would be permitted to register as either Lead Market Makers (“LMMs”) or Market Makers in one or more securities traded on OX (unless specified, or unless the context requires otherwise, the term Market Maker as used herein refers to both Market Makers and LMMs). No more than one LMM would be appointed in each option class. If registered as Market Makers, the transactions of such OTP Firms and OTP Holders “should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market, and no Market Maker should enter into transactions or make bids or offers that are inconsistent with such a course of dealings.” Specifically, a Market Maker would be required to, among other things, compete with other Market Makers to improve the market in all series of options classes to which the Market Maker is appointed, update market quotations in response to changed market conditions in all series of options classes within its appointed classes, honor its quotations, maintain continuous, two-sided quotes in a specified percentage of its appointed classes, submit

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<sup>9</sup> See proposed NYSE Arca Rule 6.1A(a)(6).

quotations in accordance with maximum Exchange prescribed width requirements, and trade a minimum percentage of its contracts in its appointed classes. A Market Maker's failure to meet these obligations may lead to a suspension, termination or other restriction of the Market Maker's registration in one or more securities or the OTP Firm's or OTP Holder's right to act as a Market Maker. LMMs would continue to be responsible for Intermarket Option Linkage ("Linkage") order handling obligations.

B. Detailed Summary of Proposed Rule Change

The proposed rule changes are located in NYSE Arca Rule 2 (Options Trading Permits) and NYSE Arca Rule 6 (Options Trading).

1. NYSE Arca Rule 2 – Options Trading Permits.

Proposed amendment to NYSE Arca Rule 2.5. Because NYSE Arca does not intend to make significant changes to membership requirements once OX is implemented, NYSE Arca proposes to amend NYSE Arca Rule 2.5 such that current members of the Exchange and their associated persons that have met the Exchange's membership requirements and passed the requisite examinations would automatically be qualified to engage in the same activities on OX for which they were previously approved by the Exchange.

2. NYSE Arca Rule 6 – Options Trading.

Proposed amendments to NYSE Arca Rule 6.1(a). Because option issues would be rolled-out on OX over a period of time, NYSE Arca proposes to amend NYSE Arca Rule 6.1(a) to clarify that rules related to option contracts traded on the existing PCX Plus trading platform would apply to options trading on PCX Plus and proposed new rules for option contracts that would trade on OX would apply only to such transactions.

Existing and amended rules that do not specify a trading platform would apply to all relevant transactions made on NYSE Arca.

Proposed NYSE Arca Rule 6.1A

In connection with the implementation of OX, NYSE Arca proposes to adopt definitions applicable to activity on OX. The most significant of the proposed definitions are as follows:

a. Proposed NYSE Arca Rule 6.1A(a)(10). NOW Recipients. As described further below, NYSE Arca proposes to add “NOW Order” as a new order type. Users would be permitted to designate orders entered on OX as “NOW Orders.” NOW Orders are limit orders that would be executed in whole or in part on OX. Any portion of such orders not executed on OX would be routed to one or more “NOW Recipients” for immediate execution. “NOW Recipients” would include any Market Center (1) with which NYSE Arca maintains an electronic linkage, and (2) that provides instantaneous responses to NOW Orders routed from OX. NYSE Arca would designate those Market Centers that qualify as NOW Recipients and periodically publish such information via its Web site. Any portion of a NOW Order not immediately executed by the NOW Recipient would be cancelled. If a NOW Order is not marketable when it is submitted to OX, it would be cancelled.

NOW Orders would allow Users to have their orders executed as quickly as possible by allowing them to choose to have their orders sent only to those Market Centers that are automated, as that term is generally understood to mean, and that do not allow for manual intervention. Through the creation of “NOW Recipients” and “NOW

Orders”, Users’ orders that are routed away would be executed as quickly as possible while the possibility that such orders would “miss” the away market would be reduced.

b. Proposed NYSE Arca Rule 6.1A(a)(15). OX Routing Broker.

NYSE Arca is proposing to add a definition for “OX Routing Broker,” NYSE Arca’s broker-dealer affiliate, Archipelago Securities LLC (“Archipelago Securities”), which NYSE Arca intends to use to route orders, subject to NYSE Arca rules, to other Market Centers. The OX Routing Broker would offer Users a fast alternative for routing orders to other Market Centers for execution.

Archipelago Securities is a wholly-owned subsidiary of Archipelago Holdings Inc. and is a registered broker-dealer and a member of NASD. Archipelago Securities is a “facility” of NYSE Arca as that term is defined in Section 3(a)(2) of Act.<sup>10</sup> Specifically, Section 3(a)(2) of the Act provides that, “[t]he term ‘facility’ when used with respect to an exchange includes its premises, tangible or intangible property whether on the premises or not, any right to use of such premises or property or any service thereof for the purpose of effecting or reporting a transaction on the exchange (including, among other things, any system of communication to or from the exchange, by ticket or otherwise maintained by or with the consent of the exchange), and any right of the exchange to the use of any property or service.” Accordingly, because Archipelago Securities functions as an order routing mechanism for NYSE Arca, it operates as a “system of communication” to and from NYSE Arca for purposes of effecting transactions on NYSE Arca. NYSE Arca would be responsible for regulating the OX

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<sup>10</sup> 15 U.S.C. 78c(a)(2).

order routing function of Archipelago Securities as an exchange facility, subject to Section 6 of the Act.<sup>11</sup> Archipelago Securities' order routing function would also be subject to the Commission's continuing oversight. In particular, under the Act, any proposed rule change relating to Archipelago Securities' order-routing function would be filed with the Commission and Archipelago Securities would be subject to exchange non-discrimination requirements.

OX would use either Archipelago Securities or Linkage to route orders to other Market Centers. Generally, non-customer orders (e.g., broker-dealer orders and Market Maker orders) and NOW Orders would be routed to other Market Centers via Archipelago Securities. P/A orders<sup>12</sup> would be routed to other Market Centers via Linkage. The OX system would not automatically generate Principal orders<sup>13</sup> on behalf of Market Makers; rather, Market Makers would be required to enter their own Principal orders if they want to have their proprietary orders routed to other Market Centers via Linkage. Certain order types, including Immediate or Cancel and PNP Orders, would not be eligible for routing away. Users, therefore, would be able to control whether certain orders may be routed away by these order designations.

OX would determine whether to route certain orders via Linkage or Archipelago Securities based on preset parameters in its automated routing algorithm. Accordingly, orders that would be eligible for routing over Linkage (e.g., public customer orders) could be routed to other Market Centers as P/A orders via Linkage or as customer orders

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<sup>11</sup> 15 U.S.C. 78f.

<sup>12</sup> See NYSE Arca Rule 6.92(a)(12)(i).

<sup>13</sup> See NYSE Arca Rule 6.92(a)(12)(ii).

via Archipelago Securities based on the automated routing algorithm parameters.

c. Proposed NYSE Arca Rules 6.1A(a)(16), (17) and (18).

Sponsored Participant, Sponsoring OTP Firm and Sponsorship Provisions. As described further below, NYSE Arca is proposing to add the concept of Sponsored Participants and Sponsoring OTP Firms. Sponsored Participants would be able to access OX for purposes of order entry and execution.

Proposed NYSE Arca Rule 6.2A

NYSE Arca is proposing NYSE Arca Rule 6.2A to govern access to OX and the expected conduct of OTP Holders, OTP Firms and persons employed by or associated with an OTP Holder or OTP Firm. OTP Holders, OTP Firms and persons employed by or associated with any OTP Holder or OTP Firm, while using the facilities of NYSE Arca, would not be permitted to engage in conduct: (i) inconsistent with the maintenance of a fair and orderly market; (ii) apt to impair public confidence in the operations of NYSE Arca; or (iii) inconsistent with the ordinary and efficient conduct of business. Activities that may violate these provisions would include, but would not be limited to: (a) failure of a Market Maker to provide quotations in accordance with NYSE Arca Rules 6.37A and 6.37B; (b) failure of a Market Maker to bid or offer within the ranges specified by NYSE Arca Rule 6.37A; (c) failure of an OTP Holder or OTP Firm to adequately supervise a person employed by or associated with such OTP Holder or OTP Firm to ensure that person's compliance with NYSE Arca Rules; (d) failure to abide by a determination of NYSE Arca; and (e) refusal to provide information requested by NYSE Arca.

In addition to the above, proposed NYSE Arca Rule 6.2A also outlines the requirements that Sponsored Participants and Sponsoring OTP Firms would be required to meet prior to engaging in a Sponsoring OTP Firm/Sponsored Participant relationship. A “Sponsored Participant” would be a person, such as an institutional investor, who has entered into a sponsorship arrangement with an OTP Firm for purposes of entering orders on OX. The following would be the requirements for access by Sponsored Participants:

Sponsored Participants would be required to enter into a sponsorship arrangement with a “Sponsoring OTP Firm,” which is defined as an OTP Firm that has been designated by a Sponsored Participant to execute, clear and settle transactions on NYSE Arca. The sponsorship arrangement consists of three separate components. First, the Sponsored Participant would have to enter into and maintain a customer agreement with its Sponsoring OTP Firm, establishing a proper relationship and account through which the Sponsored Participant would be permitted to trade on NYSE Arca. Second, the Sponsored Participant and its Sponsoring OTP Firm would have to enter into a written agreement that incorporates the following Sponsorship Provisions:

(1) The Sponsoring OTP Firm acknowledges and agrees that: (i) all orders entered by its Sponsored Participant and any person acting on behalf of or in the name of such Sponsored Participant and any executions occurring as a result of such orders are binding in all respects on the Sponsoring OTP Firm and (ii) the Sponsoring OTP Firm is responsible for any and all actions taken by such Sponsored Participant and any person acting on behalf of or in the name of such Sponsored Participant.

(2) The Sponsored Participant agrees that it would comply with the NYSE Arca Certificate of Incorporation, Bylaws, Rules and procedures with regard to its activity on the Exchange as if the Sponsored Participant were an OTP Firm.

(3) The Sponsored Participant agrees that it would maintain, keep current and provide to the Sponsoring OTP Firm a list of its Authorized Traders<sup>14</sup> who would be permitted to obtain access to the Exchange on behalf of the Sponsored Participant(s).

(4) The Sponsored Participant agrees that it would familiarize its Authorized Traders with all of the Sponsored Participant's obligations under NYSE Arca Rules and would assure that they receive appropriate training prior to any use of or access to the Exchange.

(5) The Sponsored Participant agrees that it would not permit anyone other than Authorized Traders to use or obtain access to the Exchange.

(6) The Sponsored Participant agrees that it would take reasonable security precautions to prevent unauthorized use or access to the Exchange, including unauthorized entry of information into OX, or the information and data made available therein. The Sponsored Participant understands and agrees that it is responsible for any and all orders, trades and other messages and instructions entered, transmitted or received under identifiers, passwords and security codes of Authorized Traders, and for the trading and other consequences thereof.

(7) The Sponsored Participant acknowledges its responsibility for establishing adequate procedures and controls that permit it to effectively monitor its

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<sup>14</sup> See proposed NYSE Arca Rule 6.1A(a)(1).

employees, agents and customers' use of and access to the Exchange for compliance with the terms of the Sponsorship Provisions.

(8) The Sponsored Participant agrees that it would pay when due all amounts, if any, payable to the Sponsoring OTP Firm, NYSE Arca or any other third parties that arise from the Sponsored Participant's access to and use of the Exchange. Such amounts would include, but would not be limited to, applicable exchange and regulatory fees.

Third, the Sponsoring OTP Firm would have to provide NYSE Arca with a "Notice of Consent," which acknowledges the Sponsoring OTP Firm's responsibility for the orders, executions and actions of its Sponsored Participant.

As a further condition to access to the Exchange, each OTP Firm would be required to maintain an up-to-date list of persons who could obtain access to the Exchange on behalf of the OTP Firm or the OTP Firm's Sponsored Participants, i.e., Authorized Traders, and provide the list to NYSE Arca upon request. In addition, each OTP Firm would have to have reasonable procedures to ensure that all of its Authorized Traders maintain the physical security of NYSE Arca and otherwise comply with NYSE Arca Rules. If NYSE Arca determines that an Authorized Trader has caused an OTP Firm to violate NYSE Arca Rules, NYSE Arca could direct the OTP Firm to suspend or withdraw the person's status as an Authorized Trader.

The Sponsoring OTP Firm/Sponsored Participant relationship would allow a member firm to grant access to NYSE Arca to their customers while confirming that those customers who do have access to NYSE Arca have appropriate procedures in place to comply with NYSE Arca rules. Furthermore, the identity of all individuals with access

(i.e., Authorized Traders) would have to be disclosed to the Exchange, giving the Exchange better information in the event that the Exchange determines to take action because its systems have been used inappropriately.

Proposed NYSE Arca Rule 6.32A. Proposed NYSE Arca Rule 6.32A defines “Market Maker” on the OX platform. A Market Maker on OX would be an OTP Holder or OTP Firm registered with NYSE Arca for the purpose of submitting quotes electronically and making transactions as a dealer-specialist through the OX trading platform from on the trading floor or remotely from off the trading floor. A Market Maker submitting quotes remotely is not eligible to participate in trades effected in open outcry except to the extent that such Market Maker’s quotation represents the best bid or offer on the Exchange (“BBO”). Market Makers would be designated as specialists on NYSE Arca for all purposes under the Act and the Rules and Regulations thereunder. A Market Maker on NYSE Arca would be either a Market Maker or an LMM. Unless specified, or unless the context requires otherwise, the term Market Maker in the NYSE Arca Rules refers to both Market Makers and LMMs.

Proposed NYSE Arca Rule 6.32A does not contain the same restrictions outlined in the current NYSE Arca Rule 6.32. NYSE Arca proposes to make NYSE Arca Rule 6.32 applicable to classes that would continue to trade only on PCX Plus because current NYSE Arca Rule 6.32 outlines the different types of market makers presently on the Exchange and certain restrictions and limitations applicable to such market makers. Proposed NYSE Arca Rule 6.32A clarifies that there would be only two types of Market Makers on OX (i.e., LMMs and Market Makers) and that Market Makers would be permitted to stream quotes from on or off of the trading floor. Accordingly, proposed

NYSE Arca Rule 6.32A does not direct where Market Makers have to be physically located when effecting transaction on NYSE Arca and eliminates “in-person” trading requirements applicable to market makers that trade on the floor.

Proposed NYSE Arca Rule 6.34A. NYSE Arca is proposing NYSE Arca Rule 6.34A to limit Market Maker access to OX to those OTP Holders or officers, partners, employees or associated persons of OTP Firms that are registered with NYSE Arca as Market Makers (“Market Maker Authorized Traders” or “MMATs”). Persons would be required to pass an NYSE Arca conducted examination to demonstrate their knowledge of NYSE Arca rules prior to being approved by NYSE Arca as an MMAT. NYSE Arca also would be permitted to require a Market Maker to provide additional information NYSE Arca considers necessary to establish whether a person should be approved as an MMAT. A person would be permitted to be approved conditionally as an MMAT subject to any conditions NYSE Arca’s Chief Regulatory Officer considers appropriate in the interests of maintaining a fair and orderly market.

NYSE Arca Rule 6.34A would permit NYSE Arca to suspend or withdraw the registration of an MMAT if NYSE Arca determines that: (i) the person has caused the Market Maker to fail to comply with the Rules of NYSE Arca; (ii) the person is not properly performing the responsibilities of an MMAT; (iii) the person has failed to meet the conditions described above (e.g., failed the Exchange-administered examination); or (iv) NYSE Arca believes it is in the best interest of fair and orderly markets. If NYSE Arca suspends the registration of a person as an MMAT, the Market Maker must not allow the person to submit quotes and orders on OX. The registration of an MMAT also would be withdrawn upon the written request of the OTP Firm for which the MMAT is

registered. Such written request must be submitted on the form prescribed by NYSE Arca.

Proposed NYSE Arca Rule 6.34A would allow the Exchange to know the identities of individuals accessing NYSE Arca on behalf of Market Makers and performing the functions of Market Makers. Proposed NYSE Arca Rule 6.34A also would allow the Exchange, through the Exchange's examination process, to confirm that MMATs have sufficient knowledge of Exchange rules prior to their acting as MMATs on the Exchange. Furthermore, Proposed NYSE Arca Rule 6.34A would permit the Exchange to take prompt action against MMATs who are not compliant with Exchange Rules or who are not properly performing the functions of a Market Maker thereby limiting any negative consequences of such actions.

Proposed amendment to NYSE Arca Rule 6.35. NYSE Arca is proposing changes to the manner in which Market Maker appointments are made. Consistent with current NYSE Arca Rule 6.35, Market Makers would be required to apply for an appointment in one or more options classes. NYSE Arca may appoint one LMM per option class and an unlimited number of Market Makers in each class unless NYSE Arca determines that the number of Market Makers appointed to a particular option class should be limited whenever, in NYSE Arca's judgment, system capacity limits the number of Market Makers who would be permitted to participate in a particular option class. However, NYSE Arca would not limit access to Market Makers until such time as it has submitted to the Commission for its review and approval objective criteria for limiting access to Market Makers.

NYSE Arca is proposing to increase the number of classes per OTP that a Market Maker would be permitted to select for its appointment as follows: (i) Market Makers with one OTP would have up to 100 option issues included in their appointment; (ii) Market Makers with two OTPs would have up to 250 option issues included in their appointment; (iii) Market Makers with three OTPs would have up to 750 option issues included in their appointment; and (iv) Market Makers with four OTPs would have all option issues traded on NYSE Arca included in their appointment. Market Makers would be permitted to select from among any option issues traded on NYSE Arca for inclusion in their appointment, subject to the approval of NYSE Arca.

NYSE Arca would continue to consider the following factors when determining whether to approve the appointment of a Market Maker in each security: (i) the Market Maker's preference; (ii) the financial resources available to the Market Maker; (iii) the Market Maker's experience, expertise and past performance in making markets, including the Market Maker's performance in other securities; (iv) the Market Maker's operational capability; and (v) the maintenance and enhancement of competition among Market Makers in each security in which they are appointed.

Consistent with current NYSE Arca Rule 6.35, Market Makers would be permitted to change the option issues that are included in their appointment, subject to the approval of NYSE Arca and provided that such request is made in a form and manner prescribed by NYSE Arca. In considering whether to approve Market Makers' request to change their appointment, NYSE Arca would consider the five factors set forth directly above. Market Makers would be permitted to withdraw from trading an option issue that is within their appointment by providing NYSE Arca with three business days' written

notice of such withdrawal. Market Makers who fail to give advance written notice of withdrawal to NYSE Arca may be subject to formal disciplinary action pursuant to NYSE Arca Rule 10.

Also consistent with current NYSE Arca Rule 6.35, NYSE Arca would be permitted to suspend or terminate any appointment of a Market Maker in one or more option issues under amended NYSE Arca Rule 6.35 whenever, in NYSE Arca's judgment, the interests of a fair and orderly market are best served by such action. A Market Maker would be able to seek review of any action taken by NYSE Arca pursuant to the proposed rule, including the denial of the appointment for, or the termination or suspension of, a Market Maker's appointment in an option issue or issues in accordance with NYSE Arca Rule 10.

Market Makers would continue to be required to trade at least 75% of their contract volume per quarter in classes within their appointment. However, NYSE Arca is proposing to exclude from this calculation trades effected on the Trading Floor to accommodate cross trades executed pursuant to NYSE Arca Rule 6.47, regardless of whether the trades are in issues within or without a Market Maker's appointment.

NYSE Arca periodically would conduct an evaluation of Market Makers to determine whether they have fulfilled performance standards relating to, among other things, quality of markets, competition among Market Makers, observance of ethical standards and administrative factors. In so doing, NYSE Arca would be permitted to consider any relevant information including, but not limited to, the results of a Market Maker evaluation, trading data, a Market Maker's regulatory history and such other factors and data as may be pertinent in the circumstances. If NYSE Arca finds any

failure by a Market Maker to meet minimum performance standards, NYSE Arca would be permitted to take the following actions after written notice and after opportunity for hearing pursuant to NYSE Arca Rule 10: (i) restrict appointments to additional option issues in the Market Maker's primary appointment; (ii) suspend, terminate or restrict an appointment in one or more option issues; or (iii) suspension, termination, or restriction of the Market Maker's registration in general. If a Market Maker's appointment in an option issue or issues has been terminated because it failed to meet minimum performance standards, the Market Maker would not be re-appointed as a Market Maker in that option issue or issues for a period not to exceed six months.

Proposed NYSE Arca Rule 6.37A. NYSE Arca is proposing new NYSE Arca Rule 6.37A to outline Market Maker obligations (i) generally, (ii) within a Market Maker's appointed classes, and (iii) outside of a Market Maker's appointed classes on OX. Proposed rule 6.37A generally is consistent with certain existing requirements contained in NYSE Arca Rule 6.37 (e.g., obligations within and outside of a Market Makers appointment, establishment of quotation width limitations). However, because there only would be two types of Market Makers on OX, proposed NYSE Arca Rule 6.37A eliminates requirements relevant to Remote Market Makers and Supplemental Market Makers and eliminates in person trading requirements because Market Makers would be permitted to choose the physical location from which they would submit quotes to OX. Furthermore, NYSE Arca is proposing to address Market Maker quoting obligations separately in proposed NYSE Arca Rule 6.37B.

Proposed NYSE Arca Rule 6.37B. NYSE Arca is proposing new NYSE Arca Rule 6.37B to outline Market Maker quoting obligations on OX. Market Makers would

be required to undertake a meaningful obligation to provide continuous two-sided markets in classes traded on OX. Proposed rule 6.37B generally is consistent with existing NYSE Arca Rule 6.37. Under proposed NYSE Arca Rule 6.37B, Market Makers would be permitted to enter quotations only in the classes included in their appointment. Proposed NYSE Arca Rule 6.37B also outlines the percentage of time that Market Makers must quote on the Exchange (i.e., 99% of the time the Exchange is open for trading for LMMs and 60% of the time the Exchange is open for trading for Market Makers). Market Makers quotes would be “firm” for all orders that are routed to OX (i.e., Market Makers would not specify different sizes for Customer orders and non-Customer orders; rather, Market Makers would disseminate one size and would be “firm” for any order type routed to the Exchange).

Proposed NYSE Arca Rule 6.37C. NYSE Arca is proposing new NYSE Arca Rule 6.37C that would allow Market Makers to enter on OX all permitted orders types.

Proposed NYSE Arca Rule 6.40A. NYSE Arca is proposing new NYSE Arca Rule 6.40A to provide a mechanism for limiting Market Maker risk during periods of increased and significant trading activity on OX in a Market Maker’s appointment. Unlike current NYSE Arca Rule 6.40, however, NYSE Arca is proposing to set the “n” period at one second. Pre-setting the “n” period at one second would give NYSE Arca greater control over the functioning of the risk limitation mechanism and would reduce User confusion regarding how much time must pass before the risk limitation mechanism activates.

In the proposed new rule, NYSE Arca also would no longer generate two-sided quotes on behalf of an LMM in the event that there are no Market Makers quoting in an

issue. Rather, in the event that there are no Market Makers quoting in the issue, the best bids and offers of those orders residing in the OX Book in the issue would be disseminated as the BBO. If there are no Market Makers quoting in the issue and there are no orders in the OX Book in the issue, OX would disseminate a bid of zero and an offer of zero in that issue.

Under current NYSE Arca Rule 6.40, the Exchange would disseminate a market on behalf of an LMM when there are no Market Makers quoting in a series and the Market Maker risk limitation mechanism is activated. This market is an artificial market generated by the Exchange that is not truly reflective of the LMM's market; however, the market is subject to firm quote requirements and must be honored by the LMM. NYSE Arca is proposing NYSE Arca Rule 6.40A to improve upon its current NYSE Arca Rule 6.40. Specifically, proposed NYSE Arca Rule 6.40A would disseminate a zero bid and zero offer when there are no Market Makers quoting in a series and there are no other bids or offers on the Exchange in the series. The zero bid, zero offer market is a true reflection of the market at that point in time and limits the risk exposure of Exchange Market Makers when necessary and appropriate during times of increased volatility.

Proposed Amendment to NYSE Arca Rule 6.47. NYSE Arca is proposing to amend NYSE Arca Rule 6.47 governing crosses effected on the trading floor. Consistent with the existing version of NYSE Arca Rule 6.47, the proposed amendment provides for (i) non-facilitation (“Regular Way”) crosses, (ii) facilitation crosses and (iii) solicitation crosses. In all cases, orders must be announced to the trading crowd in open outcry and all terms of the orders must be disclosed to the trading crowd. Trading crowd participants would be given a reasonable time to respond with the prices and sizes at

which they would be willing to participate in the cross. With respect to all crosses, a Trading Official would be available at each post on the trading floor to assist in the determination of what is a “reasonable time” when necessary. Trading crowd participants who make bids or offers equal to or better than the proposed cross price would be permitted to participate in a cross. With respect to facilitations, floor brokers still would be permitted to participate in up to 40% of the balance of an order to be facilitated, once bids or offers in the Book and non-member bids and offers in the trading crowd at or better than the proposed execution price have been satisfied. The Exchange believes that proposed allocation of contracts to non-members ahead of the facilitating member is consistent with Section 11(a) of the Act.<sup>15</sup> Section 11(a) of the Act 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 (collectively, “covered accounts”) unless an exception applies. Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder provide an exception to the general prohibition in Section 11(a) on an exchange member effecting transactions for its own account. Specifically, a member that “is primarily engaged in the business of underwriting and distributing securities issued by other persons, selling securities to customers, and acting as broker, or any one or more of such activities, and whose gross income normally is derived principally from such business and related activities”<sup>16</sup> and effects a transaction in compliance with the requirements in Rule 11a1-

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

<sup>16</sup> 15 U.S.C. 78k(a)(1)(G)(i). Paragraph (b) of Rule 11a1-1(T) under the Act provides that the requirements of Section 11(a)(1)(G)(i) of the Act apply if during its preceding fiscal year more than 50% of its gross revenues were derived from one or more of the sources specified in that section. See 17 CFR 240.11a1-1(T).

1(T)(a) may effect a transaction for its own account.<sup>17</sup> Among other things, Rule 11a1-1(T)(a) requires that an exchange member presenting a bid or offer for its own account or the account of another member must grant priority to any bid or offer at the same price for the account of a non-member of the exchange.<sup>18</sup> Because the proposed amendment would require the facilitating member to yield priority in the cross transaction to all non-member bids and offers, the Exchange believes that the proposed amendment is consistent with the requirements of Section 11(a) and Rule 11a1-1(T).

With respect to crossing solicited orders, NYSE Arca proposes to impose a notification requirement on floor brokers so that customers would be aware that a floor broker would be permitted to solicit liquidity to fill the customer's orders. The floor broker would be required to deliver to the customer a written notification informing the customer that its order would be permitted to be executed pursuant to proposed NYSE Arca Rule 6.47(c). Such written notification would have to disclose the terms and conditions contained in proposed NYSE Arca Rule 6.47 and be in a form approved by the Exchange.

NYSE Arca also proposes to add a new category of cross order, the Mid-Point Crossing Order. A Floor Broker who holds orders to buy and sell an option contract(s) at the mid-point between the electronically disseminated BBO in the subject option series

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In addition to any revenue that independently meets the requirements of Section 11(a)(1)(G)(i), revenue derived from any transaction specified in paragraph (A), (B), or (D) of Section 11(a)(1) of the Act or specified in Rule 11a1-4(T) will be deemed to be revenue derived from one or more of the sources specified in Section 11(a)(1)(G)(i). See 17 CFR 240.11a1-4(T).

<sup>17</sup> 15 U.S.C. 78k(a)(1)(G)(ii).

<sup>18</sup> 17 CFR 240.11a1-1(T)(a)(3).

would be permitted to cross the Mid-Point Crossing Orders. Once the Mid Point Crossing Orders have been represented in the trading crowd by open outcry, and members of the trading crowd have been given a reasonable time to respond with the prices and sizes at which they would be willing to participate in the execution of the Mid-Point Crossing Orders, the Floor Broker would be permitted to execute the Mid-Point Crossing Orders in accordance with the procedures in proposed NYSE Arca Rule 6.47 for Regular Way, facilitation or solicitation crosses, as applicable.

If a Market Maker is solicited and agrees to participate in a cross order, pursuant to NYSE Arca Rule 6.85, the Market Maker would not be permitted to be present in the trading crowd when such order is represented and executed.

Proposed NYSE Arca Rule 6.62A

In addition to certain existing order types (e.g., Limit Orders, Market Orders), NYSE Arca is proposing to add several new order types available for entry on OX.

These would include the following:

a. Proposed NYSE Arca Rule 6.62A(c). Inside Limit Order. An “Inside Limit Order” is a Limit Order, which, if routed away pursuant to NYSE Arca Rule 6.76B, would be routed to the market participant or participants with the best displayed price. Any unfilled portion of the order would not be routed to the next best price level until all quotes at the current best bid or offer are exhausted. If the order is no longer marketable it would be ranked in the OX Book pursuant to NYSE Arca Rule 6.76A.

b. Proposed NYSE Arca Rule 6.62A(e). Working Order. Working Orders consist of several existing order types (i.e., All-or-None Orders, Stop Order) as

well as several new order types (i.e., Reserve Orders, Stock Contingency Orders).

Working orders are maintained in the OX Book Working Order Process, are not disseminated on OX and are executed in accordance with NYSE Arca Rule 6.76B. A Working Order is any order that has a conditional or undisplayed price and/or size designated as a “Working Order” by NYSE Arca, including, without limitation:

(1) Reserve Order. A limit order with a portion of the size displayed and with a reserve portion of the size (“reserve size”) that is not displayed on OX.

(2) All-or-None Order (“AON Order”). A Market or Limit Order that is to be executed in its entirety or not at all.

(3) Stop Order. A Stop Order is an order that becomes a Market Order when the market for a particular option contract reaches a specified price. A Stop Order to buy becomes a Market Order when the option contract trades at or above the stop price on OX or another Market Center or when the OX bid is quoted at or above the stop price. A Stop Order to sell becomes a Market Order when the option contract trades at or below the stop price on OX or another Market Center or when the OX offer is quoted at or below the stop price. Stop Orders (including Stop Limit Orders) would not have standing in any order process in the OX Book and would not be permitted to be displayed.

(4) Stop Limit Order. A Stop Limit Order is 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 becomes a Limit Order when the option contract trades at or above the stop price on OX or another Market Center or when the

OX bid is quoted at or above the stop price. A Stop Limit Order to sell becomes a Limit Order when the option contract trades at or below the stop price on OX or another Market Center or when the OX offer is quoted at or below the stop price.

(5) Stock Contingency Order. A Stock Contingency Order is an option order the execution of which is contingent upon the last sale price as specified by the User of the underlying stock traded at the primary marketplace.

c. Proposed NYSE Arca Rule 6.62A(i). NOW Order. A “NOW Order” is a Limit Order that is to be executed in whole or in part on OX, and the portion not so executed would be routed pursuant to NYSE Arca Rule 6.76B only to one or more NOW Recipients for immediate execution as soon as the order is received by the NOW Recipient. Any portion not immediately executed by the NOW Recipient would be cancelled. If a NOW Order is not marketable when it is submitted to OX, it would be cancelled. As described above, NOW Recipients are those Market Centers that are automated and do not allow for manual intervention with respect to orders.

d. Proposed NYSE Arca Rule 6.62A(j). PNP Order. A “PNP Order” (Post No Preference) is a Limit Order to buy or sell that is to be executed in whole or in part on NYSE Arca, and the portion not so executed is to be ranked in the OX Book, without routing any portion of the order to another Market Center; provided, however, NYSE Arca would be required to cancel a PNP Order that would lock or cross the NBBO.

e. NYSE Arca Rule 6.62A(k). Mid-Point Crossing Order. A “Mid-Point Crossing Order” is an order to be crossed at the mid-point price or better of the

electronically disseminated BBO<sup>19</sup> in the relevant option series pursuant to NYSE Arca Rule 6.47; provided, however, that the mid-point must fall on a minimum price variation (“MPV”).<sup>20</sup> If the mid-point does not fall on an MPV, the Mid-Point Crossing Order would be cancelled.

The order types in Proposed NYSE Arca Rule 6.62A would provide greater flexibility to customers to control their orders. By offering order types such as the Reserve Order, customers would be able to determine how much of their order they want disseminated at any point in time and eliminates the need for customers to enter multiple orders in one series. Furthermore, NOW Orders and PNP Orders provide customers with flexibility with respect to where their orders would (or would not) be routed once they have been processed on the Exchange.

#### Proposed NYSE Arca Rule 6.64A

NYSE Arca is proposing new NYSE Arca Rule 6.64A to govern the opening process, which traditionally has been referred to as a “rotation,” and which would be referred to as an “auction” on the OX platform. A “Trading Auction” is a process by which trading is initiated in a specified options class. Trading Auctions may be employed at the opening of NYSE Arca each business day or to re-open trading after a trading halt. Trading Auctions would be conducted automatically by the OX trading platform.

The OX system would accept Market and Limit Orders and quotes for inclusion in the opening auction process (“Auction Process”) until the Auction Process is initiated

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<sup>19</sup> See proposed NYSE Arca Rule 6.1A(a)(2).

<sup>20</sup> See proposed NYSE Arca Rule 6.1A(a)(10).

in that option series. Prior to the Auction Process (“pre-opening”), non-Market Makers would be able to submit orders to OX and Market Makers would be able to submit two-sided quotes and orders to OX. Contingency orders (except for “opening only” orders) would not participate in the Auction Process. Any eligible open orders residing in the OX Book from the previous trading session would be included in the Auction Process. After the primary market for the underlying security disseminates the opening trade or the opening quote, the related option series would be opened automatically based on the following principles and procedures:

- a. The OX system would determine a single price at which a particular option series would be opened.
- b. Orders would have priority over Market Maker quotes. Orders and quotes in the OX system would be matched up with one another based on price-time priority.
- c. Orders in the OX Book that were not executed during the Auction Process would become eligible for the Core Trading Session immediately after the conclusion of the Auction Process.

To determine the opening price in a series, upon receipt of the first consolidated quote or trade of the underlying security, OX would compare the Options Price Reporting Authority (“OPRA”) NBBO market with the initial BBO market. OX would generate an opening trade if possible or open a series on the quoted market. OX then would send the OX BBO quote to OPRA.

The opening price of a series would be the price, as determined by the OX system, at which the greatest number of contracts would trade at or nearest to the

midpoint of the initial NBBO disseminated by OPRA, if any, or the midpoint of the best quote bids and quote offers in the OX Book. Midpoint pricing would not occur if that price would result in an order or part of an order being traded through. Instead the Trading Auction would occur at that limit price, or, if the limit price is superior to the quoted market, within the range of 75% of the best quote bid and 125% of the best quote offer. The same process would be followed to reopen an option class after a trading halt.

Unmatched orders and Market Maker quotes that are marketable against the initial NBBO would “sweep” through the OX Book and be executed in price/time priority. If the best price is at an away Market Center(s), orders would be routed away to the relevant Market Center(s).

Proposed NYSE Arca Rule 6.64A would allow the maximum number of contracts to be executed on the opening while giving orders priority over Market Maker quotes on the open.

Proposed NYSE Arca Rule 6.76A

NYSE Arca would display all non-marketable Limit Orders in the Display Order Process of the OX Book. Except as otherwise permitted by NYSE Arca Rule 6.76A, all bids and offers at all price levels in the OX Book would be displayed on an anonymous basis. OX also would disseminate current consolidated quotations/last sale information, and such other market information as may be made available from time to time pursuant to agreement between NYSE Arca and other Market Centers, consistent with the Plan for Reporting of Consolidated Options Last Sale Reports and Quotation Information.

Bids and offers would be ranked and maintained in the Display Order Process and/or Working Order Process of the OX Book according to price-time priority.

a. Within the Display Order Process

Limit Orders, with no other conditions, and quotes would be ranked based on the specified price and the time of original order or quote entry. The displayed portion of Reserve Orders (not the reserve size) would be ranked in the Display Order Process at the specified limit price and the time of order entry. When the displayed portion of the Reserve Order is decremented completely, the displayed portion of the Reserve Order would be refreshed for:

(1) the displayed amount; or

(2) the entire reserve amount, if the remaining reserve amount is smaller than the displayed amount, from the reserve portion and would be submitted and ranked at the specified limit price and the new time that the displayed portion of the order was refreshed.

b. Within the Working Order Process

(1) The reserve portion of Reserve Orders would be ranked based on the specified limit price and the time of original order entry. After the displayed portion of a Reserve Order is refreshed from the reserve portion, the reserve portion would remain ranked based on the original time of order entry, while the displayed portion would be sent to the Display Order Process with a new time-stamp.

(2) All-or-None Orders would be ranked based on the specified limit price and the time of order entry.

(3) Stop and Stop Limit Orders would be ranked based on the specified stop price and the time of order entry.

(4) Stock Contingency Orders would be ranked based on the specified limit price and the time of order entry.

Consistent with Rule 602 under Regulation NMS,<sup>21</sup> the best-ranked displayed bids and offers to buy and the best ranked displayed bids and offers to sell in the OX Book and the aggregate displayed size of such bids and offers associated with such prices would be collected and made available to quotation vendors for dissemination.

The Display Order Process of the OX Book in proposed NYSE Arca Rule 6.76A provides the “traditional” book found on most options exchange. The Working Order Process, a new concept with respect to options exchanges, provides a method for booking contingency order as well as other new order types such as Reserve Orders. The Working Order Process provides greater flexibility to customers because of the different order types that would be permitted to be placed in the Working Order Process for future execution.

Proposed NYSE Arca Rule 6.76B

Proposed NYSE Arca Rule 6.76B outlines the applicable requirements for order execution and priority on the OX trading platform. Unless an LMM is entitled to a guaranteed participation because he is quoting at the NBBO, all orders would be matched based on strict price-time priority. For an execution to occur in any order process, the price must be equal to or better than the NBBO, unless OX has routed orders to away Market Centers at the NBBO.

a. Proposed NYSE Arca Rule 6.76B is Consistent with Section 11(a) of the Act.

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<sup>21</sup> 17 CFR 242.602.

The Exchange believes that the proposed allocation of orders based on strict price-time priority for orders executed via OX is consistent with Section 11(a) of the Act. As described earlier herein, Section 11(a) of the Act 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 (collectively, “covered accounts”) unless an exception applies. First enacted as part of the Securities Acts Amendments of 1975,<sup>22</sup> Section 11(a) was intended by Congress to address trading advantages enjoyed by exchange members and conflicts of interest in money management.<sup>23</sup> In particular, as noted by the Commission, Congress was concerned about members benefiting in their principal transactions from special “time and place” advantages associated with floor trading – such as the ability to “execute decisions faster than public investors.”<sup>24</sup>

Where principal transactions contribute to the fairness and orderliness of exchange markets or do not reflect any time and place trading advantages, they are excepted from the prohibition. Among the transactions excepted under Section 11(a)(1)

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<sup>22</sup> See Pub. L. No. 94-29, 89 Stat. 110 (June 4, 1975).

<sup>23</sup> See Securities Reform Act of 1975, Report of the House Comm. on Interstate and Foreign Commerce, H.R. Rep. No. 94-123, 94th Cong., 1st Sess. (1975) (“House Report”); Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs, S. Rep. No. 94-75, 94th Cong., 1st Sess. (1975).

<sup>24</sup> See Securities Exchange Act Release No. 14563 (Mar. 14, 1978), 43 FR 11542, at 11543 (Mar. 17, 1978); Securities Exchange Act Release No. 14713 (Apr. 27, 1978), 43 FR 18557, at 18588 (May 1, 1978) (“1978 Release II”); Securities Exchange Act Release No. 15533 (Jan. 29, 1979), 44 FR 6084, at 6092 (Jan. 31, 1979) (“1979 Release”). The 1978 and 1979 Releases cite the House Report at 54-57.

are those by a dealer acting in the capacity of a market maker,<sup>25</sup> bona fide arbitrage or hedge transactions,<sup>26</sup> and transactions made to offset errors.<sup>27</sup> Rule 11a2-2(T) under the Exchange Act provides an exception in addition to those delineated in the statute.<sup>28</sup>

Commonly referred to as the “effect versus execute” rule, 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 directly on the exchange floor. To comply with the rule’s conditions, a member (1) must transmit the order from off the exchange floor; (2) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;<sup>29</sup> (3) may not be affiliated with the executing member; and (4) with respect to an account over which the member or an associated person has investment discretion, neither the member nor the associated person may retain any compensation in connection with effecting the transaction without express written consent from the person authorized to transact business for the account in accordance with the rule.

As described by the Commission, these four requirements – off-floor transmission, non-participation in order execution, execution through an unaffiliated member and non-retention of compensation for discretionary accounts – were “designed

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<sup>25</sup> See Section 11(a)(1)(A), 15 U.S.C. 78k(a)(1)(A). In addition to the application of Rule 11a2-2(T), members of the Exchange who are registered as market makers may also take advantage of the market maker exemption from Section 11(a), at least for securities in which they make a market.

<sup>26</sup> See Section 11(a)(1)(D) of the Act. 15 U.S.C. 78k(a)(1)(D).

<sup>27</sup> See Section 11(a)(1)(F) of the Act. 15 U.S.C. 78k(a)(1)(F).

<sup>28</sup> 17 CFR 240.11a2-2(T).

<sup>29</sup> The member may participate, however, in clearing and settling the transaction.

to put members and non-members on the same footing, to the extent practicable, in light of the purposes of Section 11(a).”<sup>30</sup> If a transaction meets the requirements of the “effect versus execute” rule, it would be deemed to be “consistent with the purpose of Section 11(a)(1) of the Act, the protection of investors, and the maintenance of fair and orderly markets.”<sup>31</sup>

OX represents a new electronic trading platform that may be utilized by Exchange members and their customers to effect the purchase and sale of securities. OX would place all of its Users – both members and non-members of the Exchange – on the “same footing,” as intended by Rule 11a2-2(T). Given OX’s automated matching and execution services, no Exchange member would enjoy any special control over the timing of execution or special order handling advantages for orders executed via OX, as all orders would be centrally processed for execution by computer, rather than being handled by a member through bids or offers made on the trading floor. Because OX’s open, electronic structure is designed to prevent any Exchange members from gaining any time and place advantages, the Exchange believes that OX satisfies the four requirements of the “effect versus execute” rule as well as the general policy objectives of Section 11(a).

Rule 11a2-2(T) requires the orders for a covered account transaction to be transmitted from off the exchange floor. In considering the application of this requirement to a number of automated trading and electronic order-handling facilities operated by national securities exchanges, the Commission has deemed the off-floor requirement to be met if the order is transmitted from off the floor directly to the

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<sup>30</sup> See 1978 Release II at 18560.

<sup>31</sup> See Rule 11a2-2(T)(e) under the Act. 17 CFR 240.11a2-2(T)(e).

exchange floor by electronic means.<sup>32</sup> Like these other automated systems, orders sent to OX would be transmitted from remote terminals directly to the system by electronic means. Therefore, the Exchange believes that Users' orders electronically received by OX satisfy the off-floor transmission requirement for the purposes of the "effect versus execute" rule.

The "effect versus execute" rule further provides that the exchange member and its associated person may not participate in the execution of the transaction once the order has been transmitted. The Exchange believes that orders submitted to OX meet the non-participation requirement. Upon submission to OX, an order would enter the queue and be executed against another order in the OX Book based on an established matching algorithm. The execution depends not on the Exchange member, but rather, upon what other orders are entered into OX at or around the same time as the subject order, what orders are resident in the OX Book and where the order is ranked based on the price-time priority ranking algorithm. Therefore, at no time following the submission of an order is an Exchange member able to acquire control or influence over the result or timing of orders generated. That is, unlike a floor broker who currently enjoys a trading advantage inherent to being present on an exchange floor for transactions being executed on that floor, no OTP Holder or OTP Firm would be permitted to take advantage of any non-

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<sup>32</sup> Among the systems considered by the Commission are (1) the Philadelphia Stock Exchange's ("Phlx") VWAP Trading System; (2) the Pacific Exchange's ("PCX") Application of OptiMark; (3) Chicago Match; (4) the American Stock Exchange's Post Execution Reporting System and the Amex Switching System (see 1979 Release at n. 25); (5) the Intermarket Trading System; (6) the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange; (7) the PCX's Communications and Execution System ("COMEX"); and (8) the Phlx's Automated Communications and Execution System ("PACE") (see 1979 Release at nn. 19-35).

member User through the use of OX. As a result, the Exchange believes the non-participation requirement is met where OTP Holder or OTP Firm orders are matched and executed automatically in OX.

Although Rule 11a2-2(T) contemplates having an order executed by an exchange member who is unaffiliated with the member initiating the order, the Commission has recognized in the past that this requirement is not applicable where automated exchange facilities are used. For example, in considering the operation of COMEX and PACE, among other systems, 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.<sup>33</sup> 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 floors, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T).<sup>34</sup> The Exchange believes that this principle is directly applicable to OX; the design of OX ensures that OTP Holders and OTP Firms do not have any special or unique trading advantages in handling their orders after transmission. Accordingly, the Exchange believes that an OTP Holder or OTP Firm effecting a transaction by utilizing OX satisfies the requirement for execution through an unaffiliated member.

Finally, the exemption in Rule 11a2-2(T) states that, in the case of a transaction effected for an account for which the initiating member exercises investment discretion, in general, the member may not retain compensation for effecting the transaction. As a

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<sup>33</sup> See 1979 Release.

<sup>34</sup> Id.

prerequisite to the use of OX, if an Exchange member is to rely on Rule 11a2-2(T) for a managed account transaction, the Exchange member must comply with the limitations on compensation as set forth in paragraph (a)(2)(iv) of the “effect versus execute” rule.

b. Execution of Orders on OX

OX first would attempt to match incoming marketable bids and offers against bids or offers in the Display Order Process at the display price of the resident bids or offers for the total amount of option contracts available at that price or for the size of the incoming order, whichever is smaller. For the purposes of proposed NYSE Arca Rule 6.76B(a), the size of an incoming Reserve Order would include the displayed and reserve size, and the size of the portion of the Reserve Order resident in the Display Order Process is equal to its displayed size. NYSE Arca proposes to allocate incoming marketable bids and offers as follows:

c. The Display Order Process

(1) If there is an LMM quoting in the option series, an incoming marketable bid or offer would be matched against all Customer orders ranked ahead of the LMM, provided that such execution(s) must occur at a price equal to or better than the NBBO. The remaining balance of the incoming marketable bid or offer would be matched against the quote of the LMM for either: (i) an amount equal to 40% of the remaining balance of the incoming bid or offer up to the LMM’s disseminated quote size; or (ii) the LMM’s share in the order of ranking in the OX Book, whichever is greater. Any remaining balance of the incoming marketable bid or offer would be matched against remaining orders and quotes in the Display Order Process in the order of their ranking.

(2) If there is no LMM quoting in the option series, the incoming marketable bid or offer would be matched against orders and quotes in the Display Order Process based upon their rankings.

(3) If the incoming marketable bid or offer has not been executed in its entirety, the remaining part of the order would be routed to the Working Order Process.

d. The Working Order Process

An incoming bid or offer that is not marketable against the Display Order Process would be sent to the Working Order Process to be executed against any Working Orders at or better than the NBBO. An incoming marketable bid or offer would be matched for execution against orders in the Working Order Process in the following manner:

(1) An incoming marketable bid or offer would be matched against orders within the Working Order Process in the order of their ranking, at the price of the displayed portion (for Reserve Orders) or at the limit price (for all other Working Order types), for the total amount of option contracts available at that price or for the size of the incoming bid or offer, whichever is smaller.

(2) If an incoming marketable order has not been executed in its entirety on OX and it has been designated as an order type that is eligible to be routed away, the order would be routed for execution to another Market Center(s). If an order has been designated as an order type that is not eligible to be routed away, the order either would be placed in the OX Book or cancelled if such order would lock or cross the NBBO.

e. Routing Away

(1) The order would be routed, either in its entirety or as component orders, to another Market Center(s) as a Limit Order equal to the price and up to the size of the quote published by the Market Center(s). The remaining portion of the order, if any, would be ranked and displayed in the OX Book in accordance with the terms of such order pursuant to NYSE Arca Rule 6.76A and such order would be eligible for execution pursuant to NYSE Arca Rule 6.76B.

(2) A marketable Reserve Order would be permitted to be routed serially as component orders, such that each component corresponds to the displayed size.

An order that has been routed away (either via Linkage or the OX Routing Broker) would remain outside of OX for a prescribed period of time (i.e., based on current required response times for Linkage orders, the prescribed period of time would be no more than 20 seconds; NYSE Arca would use the same time standard for orders routed via the OX Routing Broker) and would be permitted to be executed in whole or in part subject to the applicable trading rules of the relevant Market Center. While an order remains outside of OX, it would have no time standing, relative to other orders received from Users at the same price that would be permitted to be executed against the OX Book.

Requests from Users to cancel their orders while the orders are routed away to another Market Center and remain outside OX would be processed subject to the applicable trading rules of the relevant Market Center and relevant Linkage Plan 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 (i.e., all attempts at the fill are declined or timed-out), the order would be ranked and displayed in the OX Book in accordance with the terms of such order under proposed NYSE Arca Rule 6.76A and such order would be eligible for execution under proposed NYSE Arca Rule 6.76B.

Proposed Amendments to NYSE Arca Rules 6.32, 6.37, 6.40, 6.47, 6.62, 6.64, 6.75, 6.76 and 6.82. NYSE Arca is proposing to amend NYSE Arca Rules 6.32, 6.37, 6.40, 6.47, 6.62, 6.64, 6.75, 6.76 and 6.82 to indicate that they only apply to transactions executed on PCX Plus, or, in the case of NYSE Arca Rule 6.75, in open outcry.

## 2. Statutory Basis

The proposed rule change, as amended, is consistent with Section 6(b) of the Act,<sup>35</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>36</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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

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

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<sup>35</sup> 15 U.S.C. 78f(b).

<sup>36</sup> 15 U.S.C. 78f(b)(5).

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

Written comments on the proposed rule change were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such rule change, as amended, or
- (B) institute proceedings to determine whether the proposed rule change, as amended, should be disapproved.

IV. **Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rules-comments@sec.gov](mailto:rules-comments@sec.gov). Please include File No. SR-NYSEArca-2006-13 on the subject line.

Paper Comments:

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

All submissions should refer to File No. SR-NYSEArca-2006-13. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of NYSE Arca. 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 No. SR-NYSEArca-2006-13 and should be submitted [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>37</sup>

Nancy M. Morris  
Secretary

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<sup>37</sup> 17 CFR 200.30-3(a)(12).